(1)

Supreme Court, U.S.
FILED

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No. _____

In the Supreme Court of the United States

Patrick M. Hays,

Petitioner,

vs.

Luverne Hoffman, et al.,

Respondents,

and

United States of America,

Intervenor.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS

A nursing home manager reported Medicaid fraud by the owning conglomerate to the state agency administering Medicaid. He had discovered one of the fraud schemes, and learned of other fraud schemes from the company CFO, who refused to report it and left the company. The manager was fired. His letters on the schemes caused a state agency audit, which "disallowed" many of the claimed Medicaid reimbursements. He prosecuted this federal False Claims Act (FCA) lawsuit. The DOJ declined to intervene. The jury found that the company committed 11 different fraud schemes. The Eighth Circuit reversed the verdict on 10 of the fraud schemes as lacking jurisdiction under 31 USC §3730(e)(4)(A) and (B), which was intended to deny unworthy parasites as qui tam relators. The questions presented are:

1. As an issue of first impression, what is the correct analysis or interpretation of "original source" and the "direct knowledge" jurisdictionally required of a whistleblower for a qui tam suit?

2. Does the Eighth Circuit's holding conflict with other circuits and the rule in United States v. Bornstein, 423 U.S. 303 (1976) that the number of civil penalties imposed should be based upon the number of claims made?

3. The federal circuits are divided over whether a state audit is a "public disclosure" under the FCA jurisdiction clause.

4. The federal circuits are divided over whether the definition of "based upon the public disclosure" in the FCA jurisdiction clause means "derived from."

LIST OF PARTIES

PLAINTIFFS:

1. Patrick Hays
2. United States of America

DEFENDANTS:

1. Luverne Hoffman
2. Kay Knock
3. St. Francis Health Services of Morris, Inc.
4. Villa of St. Francis Nursing Home, Inc.
5. Browns Valley Center, Inc.
6. Franciscan Health Center, Inc.
7. Leisure Hills Health Center, Inc.
8. Prairie Community Services, Inc.
9. Prairie Community Waivered Services, Inc.
10. Prairieland Management Services, Inc.
11. St. Louis Riverview Homes, Inc.

INTERVENOR ON EIGHTH CIRCUIT APPEAL:

1. United States of America

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PETITION

Petitioner Patrick Hays prays that the Supreme Court grant a writ of certiorari to review the judgment of the Eighth Circuit Court of Appeals of April 9, 2003, where it partially reversed the judgment of the Federal District Court, Minnesota district, the Honorable James Rosenbaum presiding.

CITATIONS TO OPINIONS BELOW

The opinion of the Court of Appeals (App. A-1 to A-18) is reported at 325 F.3d 982. The opinion of the District Court (App. B-1 to B-7) is not reported.

JURISDICTION

The judgment of the United States Court of Appeals for the Eighth Circuit was entered on April 9, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTES AND CONSTITUTIONAL PROVISIONS

False Claims Act

The False Claims Act provides, in relevant part: "Any person who (1) knowingly presents, . . . a false or fraudulent claim for payment . . . is liable to the United States Government for a civil penalty of not less than $5,000 and not more than $10,000 . . ." 31 U.S.C. §3729(a)(1).

The False Claims Act also provides a jurisdiction barring provision, which provides in relevant part:

"(4)(A) No court shall have jurisdiction over an action under this Section based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.

(B) For purposes of this paragraph, "original source" means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under this section which is based on the information." 31 U.S.C. §3730(e)(4)(A), (B).

Eighth Amendment, United States Constitution

Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.

STATEMENT OF THE CASE

The jurisdiction of the district court was invoked under the False Claims Act, 31 U.S.C. §3729 et seq., and under 28 U.S.C. §1331 (general federal question jurisdiction).

Patrick Hays discovered a fraud scheme relating to apples. He discovered 9 more fraud schemes in discussions with the conglomerate's chief financial officer (CFO). The CFO refused to blow the whistle and left the company. Hays first attempted to discuss the fraud with board members of the company. He was fired as a manager within a month. He then was put on as a new personnel director at the main office of

the conglomerate. At his first day on the job, defendant CEO Hoffman immediately fired him when Hays revealed letters he had written to the Minnesota Department of Human Services (DHS) alleging Medicaid fraud. These letters informed the DHS auditors of ten areas for fraud: (1) gift apples being claimed as food; (2) maintenance workers of non-profit Medicaid homes being used in for-profit homes; (3) a defendant for-profit company, Specialized Transportation, hauling residents in a captured market setting; (4) overcharging on dietary consulting by a defendant for-profit on the Medicaid reimbursement home that Mr. Hays managed; (5) expense of a condominium being paid by the non-profit company and being personally used by defendant CEO Hoffman; (6) defendant's for-profit Specialized Transportation using a Medicaid funded Lakewood Home van; (7) fraud on the construction of a group home involving built-in extra costs of Everstrong Construction Co. on a fire loss payment; (8) non-profit group home Medicaid money being claimed on a van that was purchased with state DOT money; (9) a $413,000 payment from Kenneth Steiger, owner of a Medicaid funded nursing home, after he sold it to the conglomerate; and (10) defendant CEO Hoffman's personal use of company vans (Hays Letters, App. H-1 to H-16). Fraud in all 10 of these areas alleged by Hays was ultimately found by the jury. (Verdict, App. C-1 to C-10). [1]

Medicaid funds are joint federal and state monies. Hays's information caused a field audit by the State DHS, which disallowed Medicaid expense claims of the defendants in all 10 of these areas and a number of others. The DHS audit supervisor testified at the jury trial, consistent with his pre-trial affidavit, that if it hadn't been for Hays's written complaints, the more rare, intensive field audit, which

[1] Ultimately, twelve schemes were presented by plaintiff at trial. The jury found fraud in one more area, and rejected another alleged scheme as fraud.

discovered the "incorrect claims," may not have occurred for years. The audit also included information gathered from personal interviews of Hays. (App. E-2.) Hays received a copy of the DHS audit. Before he filed this qui tam lawsuit, a small town weekly reporter obtained the audit and published an article. It discussed only four of the areas where DHS had disallowed claimed expenses, made no mention of fraud, and concluded that the company "has not been accused of any wrongdoing." (App. D-1 to D-6.)

Hays filed this suit alleging fraud schemes and attached the DHS audits. The District Court rejected defense jurisdiction and summary judgment motions. The jury awarded Hays damages for FCA retaliation, and found 11 different fraud schemes had been committed. The district court then found, based on testimony of plaintiffs' experts who had examined the defendants' cost reports and audits, that defendants had submitted 336 claims for payment based on the 11 fraud schemes. It assessed the minimum $5,000 statutory penalty per claim, imposing the $1,680,000 fine. (App. B-6.) It rejected a defense 8th Amendment excessive fine claim that the penalty was disproportionate to the offense. It held that the defense conduct involved 11 different fraud schemes, "broad in both scope and duration," and attempts to conceal their illegal billing practices. . ." (App. B-5.)

The Eighth Circuit upheld Hays retaliation judgment. However, it also held that the State DHS audit was a prior public disclosure under the jurisdiction clause, thus barring Hays from a qui tam case unless he was an "original source," having "direct and independent knowledge of the information on which the allegations are based." It held that Hays was an original source only on the apples scheme. It then held that the number of civil penalties imposed on the defense would be eight, because eight of the defendants' facilities had

submitted claims on the fraudulent apples. It rejected the District Court's basing the number of penalties upon the number of claims for payment submitted on the scheme. (8th Cir. Op. at App. A-2 to A-18)

REASONS FOR GRANTING PETITION

I. The Eighth Circuit interpretation of the "original source" clause, 31 U.S.C. §3730(e)(4)(A)(B), conflicts with the better Ninth Circuit analysis.

The FCA's jurisdiction bar clause is notorious for its lack of clarity. United States ex rel. Brown v. Merant, Inc. (E.D. Pa. 2002) (citing treatise); and United States ex rel. Findley v. FPC-Boron Employees' Club, 105 F.3d 675, 681 (D.C. Cir. 1997).[2] It provides:

"(4)(A) No court shall have jurisdiction over an action under this Section based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.

(B) For purposes of this paragraph, "original source" means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under this section which is based on the information." 31 U.S.C. §3730(e)(4)(A)(B).

Potential whistleblowers across America, and many lower federal courts, thirst for clarity or guidelines on these

[2] Hereafter, case citations shall omit the "United States ex rel." part of the case name, for brevity.

two clauses of the federal statute. In 1999, Senator Grassley and Congressman Berman, authors of the bipartisan 1986 changes to the FCA, criticized the federal courts in the Congressional record:

> "With dismay, however, we have watched the federal courts interpret several sections of the Amendments [1986] in ways that directly contravene Congressional intent, and, of even greater significance, discourage and foreclose potential relators from bringing meritorious cases. In particular, we are extremely concerned with the courts' crabbed interpretations of the public disclosure bar -- Sec. 3730(e)(4)(A) and (B). That provision, which was drafted to deter so-called "parasitic" cases, has been converted by several circuit courts into a powerful sword by which defendants are able to defeat worthy relators and their claims. If this trend continues, we fear that the very purpose of the Amendments -- 'to encourage more private enforcement suits' -- ultimately will be undermined. See Rep. No. 99-345, at 23-24 (1986)." (App. I-1 to I-2.)

Patrick Hays has faced a "case study" in needless use of this sword, which has thwarted many citizens attempting to enforce the qui tam statute -- "Lincoln's Law."

The FCA reflects Congress's attempt to find "the golden mean between adequate incentives for whistleblowing insiders with genuinely valuable information and discouragement of opportunistic plaintiffs who have no significant information to contribute of their own." Springfield Terminal Ry. Co. v. Quinn, 14 F.3d 645, 649 (D.C. Cir. 1994). Mr. Hays is clearly on the positive side of

this "golden mean," as a whistle-blowing insider who provided "genuinely valuable information." He saw blatant elements of one fraud scheme (apples), and when the CFO of the company refused to report other schemes, he ended his career by whistleblowing the schemes to the government.

In Springfield, the relator was an employer involved in an arbitration. It caused him to suspect fraud, and his interviews with persons whom the arbitrator had worked with were essential to the relator learning of the fraud scheme. Similarly, Mr. Hays had special knowledge as a manager of a Medicaid financed home, saw one blatant scheme, and talked with the company's CFO to discover other schemes.

The court in Fallon v. Accudyne Corp., 921 F.Supp. 611, 626 (W.D. Wisc. 1995), observed: "This [state agency] investigation, however, was instigated at the request and based upon information provided by a relator. It would be fundamentally contrary to the provisions of the statute to preclude such an individual from commencing an action based upon this information. Indeed, such a person is no doubt precisely contemplated by §3730(e)(4)(B)."

Hays was unquestionably the in-fact original source to the government. Should this count for nothing? Because he received his information on most of the fraud schemes from a co-worker, the Eighth Circuit held that he did not have "direct and independent knowledge of the information." (App. A-9 to A-12) The Supreme Court should clarify the analysis of direct knowledge for the courts and potential whistleblowers. Under the Eighth Circuit stance, few but the crooks themselves could be original sources. Auditors and other professionals, who had access and the ability to investigate, could qualify. Why should this very crabbed interpretation be imposed to reject true whistleblowers? The Eighth Circuit ignored the concerns and goal of Congress. "Ordinarily, the party accused of defrauding the federal government is in

control of most of the sources of information that would effectively reveal wrongdoing. This information dynamic was, in large part, a motivating factor behind the 1986 amendments. Congress emphasized its belief that 'detecting fraud is usually very difficult without the cooperation of individuals who are either close observers or otherwise involved in the fraudulent activity.' S. Rep. 99-345, 99th Cong., 2d Sess. 4, reprinted in 1986 U.S.C.C.A.N. at 5269. Additionally, the Reporting Committee perceived the existence of 'a conspiracy of silence' to defraud the federal government. Id. at 6, reprinted in 1986 U.S.C.C.A.N. at 5281." Dunleavy v. County of Delaware, 123 F.3d 734, 745 (3rd Cir. 1997). Hays was indeed a "close observer," who broke the silence. See the Congressional authors' critique of "original source" interpretations. (App. I-10 to I-12.)

Even if Hays had wanted to investigate the company books surreptitiously, and risk alerting the CEO or other perpetrators, he wasn't trained in accounting or auditing. In that he is similar to the relator in Cooper v. Blue Cross & Blue Shield of Florida, 19 F.3d 562 (11th Cir. 1994). Cooper was deemed an original source, even though he clearly obtained essential information for understanding the fraud from federal government officials! He had direct knowledge of his own medical bills being shoved onto Medicare when they were supposed to be paid by BCBS. He never had access, or financial audit training, to investigate the BCBS transactions. The Cooper court held that it is not necessary for a relator to have all of the relevant information. It favorably cited FCA author Senator Grassley that "a party with knowledge of fraud against the government should be able to maintain a qui tam action as long as he had some of the information in advance of the public disclosure." 1990 implementation hearing, at 3. Cooper, 19 F.3d at 564, 568.

In Seal v. Seal, 255 F.3d 1154 (9th Cir. 2001), the 9th Circuit recently provided a helpful four-factor analysis to determine if a whistleblower is an original source, with direct and independent knowledge: (1) the degree to which the relator's information helped uncover the later allegations; (2) the degree to which other private actors helped uncover those allegations; (3) the degree to which the government played a role in uncovering those allegations; and (4) whether any later discovered allegations are brought against the same entity as the earlier allegations. If this analysis had been used for Mr. Hays, he, the jury and the government would not have been barred from bringing justice to the perpetrators on 10 different fraud schemes.

A Seal case type analysis would cure the glaring injustice that occurred to Mr. Hays and that Congress specifically critiqued: "Indeed, one court held that even if it was the relator him or herself who had reported the fraud to the federal government, their case was precluded on the theory that the government had knowledge of the fraud before the relator filed their case." (App. I-3.)

The 8th Circuit pointed to its decision in Barth v. Ridgedale Elec., Inc., 44 F.3d 699, 703 (8th Cir. 1995), where it claimed that "direct" knowledge is knowledge "marked by the absence of an intervening agency." But what is an "intervening agency?" If it is a federal agency that had already discovered the fraud, such a rule would be appropriate. If, however, an "intervening agency" is taken to mean any human or entity supplying any of the information or schemes, it can lead to ludicrous, unjust results. The successful relator in Cooper may have been rejected because he clearly obtained valuable information from federal government officials. The court in Barth also favorably cited the statement: "A relator is said to have direct knowledge of fraud when he 'saw [it] with is own eyes.'" Wang v. FMC

Corp., 975 F.2d 1412, 1417 (9th Cir. 1992). However, if this was the standard, relators seldom would be anyone but the crooks themselves. Congress never adopted these very restrictive definitions. There is a danger in the courts adopting blanket statements in the first look at an issue, and applying them in a blanket fashion to unfairly bar relators in different fact contexts. The Ninth Circuit obviously stepped away from this trap by not letting the blanket statement in Wang stop it from adopting the more common sense and just analysis in Seal.

Could anyone seriously question that Congress's intent was to reward whistleblowers who worked in a company, learned of the fraud, and came forward with the schemes to the government, when no one else would? Especially in the instant case, where prior state DHS audits had failed to discover the schemes? (See Aff. of DHS audit supervisor Burns, para. 3 and 4: App. E-2 to E-3) The 8th Circuit's crabbed definition of "direct knowledge" here makes a mockery of its earlier view of the FCA jurisdiction clause: "The acts jurisdictional scheme is designed to promote private citizen involvement in exposing fraud against the government, while at the same time prevent parasitic suits by opportunistic latecomers who add nothing to the exposure of the fraud." Rabushka v. Crane Co., 40 F.3d 1509 at 1511 (8th Cir. 1994). Its Hays holding also flies in the face of Congressional intent: "The Act rewards those brave enough to speak in the face of a "'conspiracy of silence,' and not their mimics." (Senate Report, at 6, 1986 U.S.C.C.A.N. 5271) (Quoted in Wang, 975 F.2d at 1419).

The 8th Circuit in Hays also misused the requirement of "independent knowledge" that has been apparently agreed upon by it and other circuits. In Barth v. Ridgedale Elec. Inc., 44 F.3d 699 at 703 (8th Cir. 1995), it held: "'independent knowledge' has been consistently defined as knowledge that

is not dependent on public disclosure." (Citing Stinson, Lyons, Gerlin & Bustamante, P.A. v. Prudential, 944 F.2d 1149, 1160 (3rd Cir. 1991)) Yet in its reasons for barring Hays, it criticizes him for not having information "independent" of the CFO, who was not willing to report the fraud. (App. A-11.)

Congressional intent would be much better served by a multi-factor analysis to determine what whistleblowers have "direct" knowledge. Even if this Court declined such an analysis, a rule that any employee who reports fraud schemes to the government from within the company is an original source fits squarely with Congress's goal. The Third Circuit aptly observed: "The paradigmatic 'original source' is a whistleblowing insider. This covers those the Senate Report specifically referred to: 'individuals who are close observers or otherwise involved in the fraudulent activity.' S. Rep. No. 345, at 4, reprinted in U.S. Code Cong. & Admin. News 5269. Other relators may also qualify if their information results from their own investigations." Stinson v. Prudential Ins., 944 F.2d 1149, 1161 (3rd Cir. 1991).

In these times where massive corporate frauds are coming to light, resolution of this issue by the Supreme Court is extremely important for the American public. Potential insider whistleblowers will go to lawyers in the future. Holdings like the Eighth Circuit's in Hays, and blanket language like "intervening agency" will undoubtedly cause some insiders to decline the risk of reporting to the government or initiating a qui tam suit. If they aren't the crooks themselves, or don't have access or training to "see it with their own eyes," they and their lawyers may ultimately be thrown out of court. The "conspiracy of silence" will be promoted.

II. The Eighth Circuit's holding conflicts with other circuits and the rule in United States v. Bornstein, 423 U.S. 303 (1976) that the number of civil penalties imposed should be based upon the number of claims made.

United States v. Bornstein, 423 U.S. 303 (1976) rejected a theory that the number of FCA civil penalties should be based upon the number of contracts involved in a case. "The language of the statute focuses on false claims, not on contracts." 423 U.S. at 311, 96 S. Ct. at 528-529. Justice Rehnquist authored a dissent, joined by Chief Justice Burger and Justice White. They criticized the majority for imposing only three civil penalties upon the frauding company, a subcontractor, that caused the prime contractor to submit 35 false claims to the government. While agreeing that the number of actual claims made was the statutory focal point for number of penalties, they stressed that there may have been factual ties of the frauding company to the 35 prime contractor's claims submitted. Bornstein, 423 U.S. at 317-25. The Eighth Circuit here ignored this clear law, basing the number of civil penalties upon the number of the company's facilities that submitted the false claims, only 8! If this stands as law, any adroit Medicaid fraud purveyor could reduce its exposure by funneling all of its fraudulent claims through one facility!

"If a nursing home includes unjustified expenses in its cost report, the reimbursement rate will be inflated and its application to the monthly claim for reimbursement will result in an overpayment from the medicaid fund." Woodard v. Country View Care Center, Inc., 797 F.2d 888-9 (10th Cir. 1986). One of plaintiff's expert witnesses at trial of this case, Robert Rau, a former government Medicaid auditor and current private home manager, testified that he followed the fraud through 27 annual cost reports of the defendants' homes and the audits, and found 200 monthly payment claims made

on the apples fraud scheme. (App. G-1 to G-4.) DHS audit supervisor Burns verified that payment claims were made monthly. (App. F-1 to F-2.) Both the magistrate and the district court judge, who witnessed experts Rau and Burns at trial, concluded that their testimony was sufficient to establish the number of claims made through the multiple homes and on the 11 fraud schemes. Even if the Eighth Circuit was right in using the jurisdiction clause to slash the jury's finding of 10 other fraud schemes, it should have followed Bornstein in imposing 200 civil penalties, instead of 8, on the apples scheme. At the least, it could have remanded for further hearing or evidence.

The Eighth Circuit is also in conflict with other federal courts. In Brown v. United States, 524 F.2d 693, 705-6 (Ct. Cl. 1975), the 14 civil penalties were based upon the claims made (14 purchase orders), rejecting the contractor's argument that the FCA penalty should only be assessed for each project or house that he worked on. In Miller v. United States, 550 F.2d 17 (Ct. Cl. 1977), the court upheld the number of claims being the five monthly billings by the violator, even though 11 fraudulent invoices were consolidated into those five billings. In United States v. Grannis, 172 F.2d 507, 515-16 (4th Cir. 1949), the court held that the many scheduled papers that went in with each payment voucher request should not serve as individual FCA claims. In United States v. Woodbury, 359 F.2d 370, 377-8, (9th Cir. 1966), the court held that there were 10 claims subject to the penalty, rejecting the government's claim of 32 false claims. The actual requests for payment totaled 10, and the court refused to count the number of false papers attached to each particular claim submitted. In United States v. Ehrlich, 643 F.2d 634 (9th Cir. 1981), a HUD contractor argued that because he really only did one fraudulent act, inflate construction costs, he shouldn't suffer 76 civil penalties, one for each monthly voucher that he submitted for

payment. The court rejected the argument, specifically referring to Bornstein. In the instant case, defendants did not simply conduct one scheme, like inflating construction costs. The jury found that they had committed 11 different false claim schemes. Yet the 8th Circuit has ignored Bornstein and imposed only 8 civil penalties! In Woodard, liability was found against the nursing home and its managers for false Medicaid expense reimbursement claims, like the Hays case here. The trial court's imposition of penalties on "25 false claims" and "4 cost reports" was apparently uncontested. 797 F.2d 888, 891.

It is apparent from the 8th Circuit's Opinion that its goal was to lower the amount of the civil penalties on the defendants here. (Opinion, App. A-16 to A-17) This shouldn't excuse ignoring the statutory and Supreme Court mandate of Bornstein. In contrast to the 8th Circuit, the District Court, the Honorable James Rosenbaum, took on the real issue that bothered the 8th Circuit, whether the total civil penalty imposed was excessive. In holding that it was not, Judge Rosenbaum observed that it is not clear whether the 8th Amendment Excessive Fines Clause protects corporations, or whether it applies to qui tam actions. (Dist. Ct. Op., App. B-3.)

Allowing the 8th Circuit decision in Hays to stand, contrary to Bornstein, would leave a conflict within the circuits. It would also leave uncertainty in the district courts on what basis should be used to count the number of FCA penalties. Lastly, the 8th Circuit position would cause ongoing injustice in that circuit, and perhaps across the country, exemplified by this case. Mr. Hays is deprived of any reward for exposing 10 different fraud schemes through the risk and work of a jury trial and appeal, and the fraud perpetrator evades responsibility for 10 schemes.

III. A state audit is not a public disclosure that may bar a qui tam relator under the FCA jurisdiction clause.

Section 3730(e)(4)(A) provides that the source of a public disclosure must be a "criminal, civil, or administrative hearing. . . a congressional, administrative or Government Accounting Office report, hearing, audit, or investigation, or . . . the news media." In Dunleavy v. County of Delaware, 123 F.3d 734, 745 (3rd Cir. 1997), the court reasoned that because the second use of the word "administrative" in this clause is surrounded by "congressional" and "Government Accounting Office," Congress must have meant to include only federal agency reports, hearings, audits or investigations. The court concluded that a state agency disclosure may never be a jurisdictional bar under this FCA clause. Indeed, as the 9th Circuit has pointed out, "one may presume that Congress acted intentionally in including the modifying language in one clause, but omitting it in another." A-1 Ambulance Service, Inc. v. California, 202 F.3d 1238 (9th Cir. 2000). Why include "administrative hearing" twice unless one was meant for federal and one non-federal?

In Fallon v. Accudyne Corp., 921 F. Supp. 611 (W.D. Wisc. 1995), the court held that a State DNR investigation should not be a public disclosure. This case was praised by the Congressional authors of the 1986 Amendments (App. I-8) In Fine v. MK-Ferguson Co., 99 F.3d 1538, 1541-2 (10th Cir. 1996), relator was barred by a federal audit, not the prior state audits, even though they were given to the federal government. In Schwedt v. Planning Research Corp., Inc., 39 F.Supp. 2nd 28, 31-33 (D.D.C. 1999) the parties never disputed that a federal OIG report was a "public disclosure." The report was prepared for OIG by a contracted private accounting firm. In Dunleavy, the court held that a Grantee Performance Report, required by federal law to be prepared by a county and provided to HUD, was not an "administrative

report" under the jurisdiction bar clause, because it was not prepared by a federal agency. The court aptly pointed out that "expansion of the FCA's definition of 'administrative report' to state and local government reports would in effect return us to the unduly restrictive 'government knowledge' standard" . . . that "barred all actions where it could be shown, no matter how attenuated the case, that the information on which the qui tam suit was based had passed into the possession of the federal government prior to the suit's filing." 123 F.3d at 745-6.

The Eighth Circuit in this case held that because the federal government delegates the administration of Medicaid to state agencies, including investigation of fraud, the state audit in this case was tantamount to a federal audit for jurisdiction bar purposes. (App. A-6 to A-9) This is a faulty construction. It is a resurrection of the old government knowledge bar. Also, Congress specified only the enumerated public disclosures because it felt that they would clearly alert the federal government to investigate the fraud. There is no evidence that state DHS Medicaid audits that discover disallowed claimed expenses ever reach a federal investigative agency or the local U.S. attorney office. Even speculating that they do, there is no evidence that these federal offices are capable of or pursue the annual thousands of such discoveries across the 50 states. It takes an inside whistleblower like Mr. Hays to point out the fraud schemes. The "1986 amendments also reflected Congress's recognition that the government simply lacks the resources to prosecute all viable claims, even when it knows of fraudulent conduct." Schumer v. Hughes Aircraft Co., 63 F.3d 1512, 1519 (9th Cir. 1995).

Congress specifically has criticized non-media disclosures that were not clearly federal: "Disclosure in a

state proceeding of any kind should not be a bar to a subsequent qui tam suit." (App. I-5.)

The public importance is clear. Allowing a state audit as a bar would promote the ugly situation where whistleblowers' attorneys would advise clients not to report fraud to an appropriate state investigating agency; instead start the lawsuit right away and try to do your own investigation, regardless of how incompetent. The conflict between the circuits begs for clarity that could end years of litigation in the courts. It is also important to prevent the law from forcing absurd, unfair results -- barring whistleblowers who caused the state audits in the first place, and allowing companies to escape any penalty for fraud schemes.

IV. The Fourth Circuit is correct that "based upon" in the FCA jurisdiction clause should have its plain language meaning of "derived from."

The circuits are also in conflict over what "based upon" means in the FCA jurisdiction clause.[3] In Siller v. Becton Dickenson & Co., 21 F.3d 1339 (4th Cir. 1994), the Court interpreted it to mean "derived from." One panel of the Seventh Circuit agreed in United States v. Bank of Farmington, 166 F.3d 853, 863 (7th Cir. 1999). This would comport with the common sense or plain language meaning of the statute. It would also comport with the obvious intent of Congress - - barring true parasites of prior public disclosure.

However, the Eighth Circuit has chosen to adopt a "substantially similar to" definition of "based upon." The same "crabbed" interpretation has been adopted by a majority

[3] This issue was not briefed at the Eighth Circuit as it had just decided the Nurse Anesthetists case after the Hays jury trial. The issue was briefed in the district court jurisdiction motions.

of the circuits: "A qui tam suit is 'based upon' a public disclosure whenever the allegations in the suit and in the disclosure are the same, 'regardless of where the relater obtained his information.'" Minn. Ass'n. of Nurse Anesthetists v. Allina Health Sys. Corp., 276 F.3d 1032, 1034-47 (8th Cir. 2000), cert. denied, 123 S. Ct. 345 (2002); Doe v. John Doe Corp., 960 F.2d 318, 324 (2nd Cir. 1992); Findley v. FPC-Boron Employees' Club, 105 F.3d 675, 682-85 (D.C. Circ. 1997); Mistick PBT v. Housing Auth., 186 F.3d 376, 385-88 (3rd Cir. 1999), cert. denied, 120 S.Ct. 1418 (2000); McKenzie v. BellSouth Telecom., Inc., 123 F.3d 935, 940 (6th Cir. 1997); Lamers v. City of Green Bay, 168 F.3d 1013, 1017 (7th Cir. 1999); Biddle v. Board of Trustees of the Leland Stanford, Jr., Univ., 161 F.3d 533, 536-40 (9th Cir. 1998); Precision Co. v. Koch Indus., Inc., 971 F.2d 548, 552-53 (10th Cir. 1992); and Cooper v. BlueCross and BlueShield, 19 F.3d 562, 567 (11th Cir. 1994).

This majority rule distorts the plain meaning of "based upon the public disclosure." The phrase obviously is intended to mean a causal connection. The Fourth Circuit aptly observed: "We are unfamiliar with any usage, let alone a common one or a dictionary definition, that suggests that 'based upon' can mean 'supported by.'" Siller, 21 F.3d at 1349. The majority view also causes a return to the broad "government knowledge" bar that was a major reason for the 1986 changes by Congress. The D.C. Circuit in the majority view admitted: "Our interpretation of the jurisdictional bar may on occasion prevent qui tam lawsuits that may not be truly 'parasitic'." FPC-Boron Employees' Club, 105 F.3d at 685. This is what happened to Mr. Hays, and is happening to other true whistleblowers across America.

Even the Eighth Circuit, in adopting the majority view, admitted that it was "not free of strain." Nurse Anesthetists, 276 F.3d at 1047. The analysis is this: "If a suit

is only based upon a public disclosure if it results from the disclosure, . . . then the statute's additional provision allowing suit if the relator is 'an original source' of the underlying information is of no effect, because no one could be an original source if his knowledge was derived from public disclosure." Nurse Anesthetists, 276 F.3d at 1045. However, this analysis ignores the common situation where the relator reports some of the fraud schemes or information, and a resulting federal audit or investigation provides more. Chief Judge Becker of the Third Circuit, in his dissent, raised this very plausible scenario. Mistick PBT, 186 F.3d at 399. Also, even if there is a contradiction, it is plausible that Congress never saw or intended it. Nevertheless, we have a majority of the circuits using this strained analysis to impose yet another unfair roadblock to true whistleblowers from all over America, contrary to the goal of Congress.

In sum, the authorities are in substantial disarray on matters of importance to American whistleblowers, the public and the courts. America is currently embroiled in exposing corporate fraud. The nation deserves to have "Lincoln's Law" clarified for our times. This case presents a rare opportunity for this Court to address disputed jurisdiction and statutory interpretation issues for much-needed certainty in this area.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully Submitted,

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July, 2003

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 01-3888
No. 01-3891

Patrick M. Hays; United States ex rel. Patrick M. Hays,	*	
Plaintiffs - Appellees/ Cross Appellants,	*	
United States of America,	*	Appeals from the United States District
Intervenor on Appeal,	*	Court for the District of Minnesota.
v.	*	
Luverne Hoffman, et al.,	*	
Defendants - Appellants/ Cross Appellees.	*	

Submitted: November 4, 2002
Filed: April 9, 2003

Before WOLLMAN, FAGG, and LOKEN,* Circuit Judges.

LOKEN, Circuit Judge.

Patrick M. Hays was fired by St. Francis Health Services of Morris, Inc. (SFHS), the day after Luverne Hoffman, the

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* The Honorable James B. Loken became Chief Judge of the United States Court of Appeals for the Eighth Circuit on April 1, 2003.

chief executive officer of SFHS, learned that Hays had sent whistleblower letters to the Minnesota Department of Human Services (DHS), the agency that administers the Medicaid program in Minnesota. Prompted by Hays's letters, DHS conducted a field audit of the numerous nursing homes and intermediate care facilities operated by SFHS. The audit resulted in several downward adjustments to SFHS's payment rates because of noncompliance with the Medicaid reimbursement rules. Hays obtained copies of the audit reports and commenced this action under the federal False Claims Act (FCA), 31 U.S.C. §§ 3729-3733, asserting a claim for retaliatory discharge, see 31 U.S.C. § 3730(h), and qui tam[1] claims seeking damages and civil penalties for false or fraudulent claims for Medicaid payments, see 31 U.S.C. §§ 3729(a), 3730. Hays sued SFHS, eight of its operating subsidiaries, Hoffman, and Kay Knock, another SFHS corporate officer.

Defendants moved to dismiss the qui tam claims, arguing the district court lacked subject matter jurisdiction by reason of the FCA's public disclosure bar. See 31 U.S.C. § 3730(e)(4). The district court denied that motion, later explaining its analysis during the jury instructions conference. After trial, the jury found that defendants had submitted false claims regarding eleven different items, but that these false claims caused no measurable damages to the United States. The district court then determined that defendants submitted a total of 336 false claims and imposed the statutory minimum $5,000 fine for each false claim resulting in a total fine of $1,680,000. The jury also found that SFHS and Hoffman

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[1] qui tam action is one in which a private plaintiff sues on behalf of the government under a statute that awards part of any penalty recovered to the plaintiff and the remainder to the government.

unlawfully retaliated when they fired Hays and awarded him $771,736 for lost wages and benefits on that claim. The court entered judgment for $1,680,000 plus $771,736 plus interest on the back pay component of the retaliation award plus costs and attorney's fees.

Defendants appeal the qui tam portion of the judgment, raising numerous issues.[2] The United States intervened on appeal to oppose defendants' contention that the total penalty violates the Excessive Fines Clause of the Eighth Amendment and to express its views regarding the public disclosure bar issues. We conclude that the DHS audit reports were relevant public disclosures of the allegations underlying the qui tam claims, and that Hays was an original source of only one of those disclosures. Therefore, the district court lacked jurisdiction over most of the qui tam claims. We also decline to apply the district court's method of determining the number of false claims to the remaining claims and substantially reduce the total fine imposed.

I. The Public Disclosure Bar.

First enacted in 1863, the FCA provides cash bounties to private citizens who successfully bring suit against those who defraud the federal government. The public disclosure bar at issue was part of the 1986 FCA amendments. See False Claims Amendments Act of 1986, Pub. L. No. 99-562,100

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[2] In response to a question at oral argument, defense counsel suggested that the appeal includes the question whether defendants are entitled to a new trial on the retaliation claims. But that question was not included in their statement of the issues, see F.R.A.P. 28(a)(5), nor was it argued in their briefs. Accordingly, it was not preserved for appeal. That portion of the district court's judgment is affirmed.

Stat. 3153, 3157 (1986). These extensive amendments were intended to encourage private enforcement suits by legitimate whistleblowers while barring suits by opportunistic qui tam plaintiffs who base their claims on matters that have been publicly disclosed by others. See generally United States ex rel. Minn. Ass'n of Nurse Anesthetists v. Allina Health Sys. Corp., 276 F.3d 1032,1040-43 (8th Cir.), cert. denied, 123 S. Ct. 345 (2002); United States ex rel. Springfield Terminal Ry. Co. v. Quinn, 14 F.3d 645, 649-51 (D.C. Cir.1994); United States ex rel. Stinson, Lyons, Gerlin & Bustamante, P.A. v. Prudential Ins. Co., 944 F.2d 1149,1152-54 (3d Cir.1991); S. REP. No. 99-345, 99th Cong., 2nd Sess., reprinted in 1986 U.S.C.C.A.N. 5266.

The FCA's public disclosure bar, which Congress expressly declared to be jurisdictional, is found in 31 U.S.C. § 3730(e)(4)(A):

> No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless ... the person bringing the action is an original source of the information.

The operative words in this statute have prompted extensive litigation and divergent judicial interpretations. "Virtually every court of appeals . . . agrees on one thing, however: the language of the statute is not so plain as to clearly describe which cases Congress intended to bar." United States ex rel. Findlev v. FPC-Boron Employees' Club, 105 F.3d 675, 681(D.C. Cir.), cert. denied, 522 U.S. 865 (1997). The circuits

also agree that the jurisdictional inquiry turns on four questions:

> (1) whether the alleged "public disclosure" [was made by or in] one of the listed sources; (2) whether the alleged disclosure has been made "public" within the meaning of the FCA; (3) whether the relator's complaint is "based upon" this "public disclosure"; and if so, (4) whether the relator qualifies as an "original source" under § 3730(e)(4)(B).

United States ex rel. Holmes v. Consumer Ins. Group, 318 F.3d 1199,1203 (10th Cir. 2003) (en banc). Hays, as the party invoking federal jurisdiction, bears the burden of establishing the district court's jurisdiction under the FCA. See Kokkonen v. Guardian Life Ins. Co. of Am., 511 U.S. 375, 377 (1994).

In this case, the second and third questions are beyond dispute. Hays obtained copies of the DHS audit reports through a phone call to the official in charge of the SFHS audit. That was sufficient publication of the reports. See United States ex rel. Fine v.. MK-Ferguson Co., 99 F.3d 1538, 1545 (10th Cir. 1996). Hays virtually concedes he drew the factual allegations in his qui tam complaint from the DHS audit reports. Indeed, his complaint restated the findings of the audit and attached copies of the audit reports. A suit is "based upon" a public disclosure if the allegations are "derived from" or "supported by" the disclosure. Nurse Anesthetists, 276 F.3d at 1045,1047. Thus, the fighting jurisdictional issues in this case are whether the DHS audit reports fall within the enumerated sources of public disclosure, and whether Hays was an original source of some or all of the allegations and transactions disclosed in those audit reports.

A. The DHS Audit Reports Were Public Disclosures.

Section 3730(e)(4)(A) provides that the source of a public disclosure must be a "criminal, civil, or administrative hearing ...a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or ... the news media." Only public disclosures from one of these enumerated sources may give rise to the FCA jurisdictional bar. See e.g., United States ex rel. Rabushka v. Crane Co., 40 F.3d 1509, 1513 n.2 (8th Cir. 1994), cert. denied, 515 U.S. 1142 (1995). Hays and the United States as intervenor argue that the DHS audits and audit reports do not fall within the category of "administrative . . . report [or] audit" because they were not conducted and prepared by an agency of the *federal* government. They rely upon United States ex rel. Dunleavy v. County of Delaware, 123 F.3d 734, 745 (3d Cir.1997), where the court reasoned that because the second use of the word "administrative" in § 3730(e)(4)(A) is surrounded by "congressional" and "Government Accounting Office," Congress must have meant to include only reports, audits, and investigations of federal government agencies. The district court noted but did not address this issue. We reject the Third Circuit's textual approach and conclude that Medicaid compliance audits and audit reports conducted and prepared by the state agency authorized to administer this cooperative federal/state program are public disclosures within the meaning of § 3730(e)(4)(A).

In the first place, applying the Third Circuit's contrary ruling to the federal Medicaid and Medicare programs would produce anomalous results. When Congress amended the FCA in 1986, it defined "claim" to include requests for money made to grantees of the federal government, see 31 U.S.C. § 3729(c). The legislative history explained this was done to clarify that false claims for FCA purposes include claims

submitted to state agencies under the Medicaid program and other "State, local, or private programs funded in part by the United States where there is significant Federal regulation and involvement." S. REP. No. 99-345 at 22,1986 U.S.C.C.A.N. at 5287. It would be an inconsistent interpretation of the 1986 amendments to conclude that a fraudulent payment request submitted to DHS is a false claim against the United States for purposes of § 3729(c), but a DHS audit is not an "administrative audit" for purposes of § 3730(e)(4)(A) because DHS is not a federal agency.

In the second place, this subpart of § 3 73 0(e)(4)(A) has not been rigidly limited to disclosures by federal agencies or legislative bodies in other contexts. For example, under Medicare, Congress has delegated many administrative tasks to private insurance companies. In Nurse Anesthetists, 276 F.3d at 1043-44, we described an audit performed by an insurer for the federal Department of Health and Human Services (HHS) as an "administrative audit" that could trigger the jurisdictional bar. Similarly, in United States ex rel. Schwedt v. Planning Research Corp., 39 F. Supp. 2d 28, 31-33 (D.D.C.1999), the court held that public disclosures in an audit report prepared for the federal government by an outside accounting firm satisfied the jurisdictional bar. These cases suggest that anti-fraud compliance audits conducted by state or local agencies or private contractors should qualify as public disclosures if they are prepared by or at the behest of the relevant federal agency, or by or at the behest of a state agency that administers the federal grant program under "significant Federal regulation and involvement."

Construing the term" administrative . . . report [or] audit" in this fashion, we conclude that the DHS audits here in question, like the private Medicare audits at issue in Schwedt, clearly qualify. Medicaid, codified at 42 U.S.C. §§ 1396 et

seq., is a cooperative federal-state program through which the federal government provides financial assistance to assist States in furnishing health care to the poor. See Wilder v. Virginia Hosp. Ass'n, 496 U.S. 498, 502 (1990). State governments administer Medicaid, but they function under detailed federal statutory and regulatory controls in exchange for -fifty percent federal financing. Participating States must develop a state plan for medical assistance, develop cost-based payment rates to reimburse medical providers for services rendered to eligible recipients, and designate a single agency to evaluate cost reports submitted by private vendors of health services and reimburse vendors for allowed expenses. See 42 U.S.C. § 1396a(a); 42 C.F.R. § 431.10(b)(1). The designated agency, here DHS, must audit records that support cost-based payments to vendors. 42 C.F.R. § 447.202. And it must adopt a Fraud Detection and Investigation Program meeting strict federal standards. The agency must conduct a preliminary investigation whenever it receives a complaint of Medicaid fraud or abuse "from any source." It must request a full investigation by the state's Medicaid Fraud Control Unit "[i]f the findings of [the] preliminary investigation give [DHS] reason to believe that an incident of fraud or abuse has occurred in the Medicaid program." 42 C.F.R. §§ 455.14, 455.15(a); see also MINN STAT. § 256B.04, subd.10. And it must report the findings of those investigations to HHS, 42 C.F.R. § 455.17(b), setting the stage for either federal or state criminal or civil enforcement actions. See MINN RULES § 9549.0041, subp.15.C.

Viewed from this perspective, the Third Circuit's decision in Dunleavy is readily distinguishable on the facts. The alleged public disclosure in that case was a county Grantee Performance Report submitted to the Department of Housing and Urban Development by the unit of local government

accused of violating the FCA. As the Third Circuit noted, "those reports have been compiled and produced by a party whose principal motivation. (assuming the truth of the fraud claim) is the elimination of the paper trail of fraud." 123 F.3 d at 745. Moreover, under the federal grant program at issue in Dunleavy -- the Housing and Community Development Act of 1974 -- grantee compliance audits are conducted by federal agencies, HUD and the General Accounting Office. See 42 U.S.C. § 5304(e), (f). Congress did not delegate that function to a state agency, as is the case with Medicaid. Thus, while we do not disagree with the Third Circuit's decision in Dunleavy, we conclude the court ruled more broadly than necessary in stating that a state agency disclosure may never be an "administrative ... report [or] audit" for purposes of § 3730(e)(4)(A).

B. Hays Was Not an "Original Source" of Most Claims.

Though we conclude all of Hays's false claim allegations were publicly disclosed in the DHS audit reports, his FCA qui tam claims are not barred by § 3730(e)(4)(A) to the extent he is an original source of the publicly disclosed information. In the 1986 amendments, Congress defined "original source" as "an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action...based on the information." § 3730(e)(4)(B). Thus, the original source doctrine limits the rewards of a qui tam action to one who has direct knowledge of the alleged false claims that is independent of the public disclosure, and who has functioned as a true whistleblower by volunteering his direct and independent knowledge to the government before filing suit. "A whistleblower sounds the alarm; he does not echo it." Hagood v. Sonoma County Water

Agency, 81 F.3d 1465, 1475 (9th Cir.) (quotation omitted), cert. denied, 519 U.S. 865 (1996).[3]

Hays argues that he was an original source of all the information in the DHS audit reports because his whistleblower letters were the reason DHS conducted its field audit. The district court agreed, commenting:

> If a man is able to discern a small amount of fraud and there is in fact a seething snake pit ... and he is the one who tips off the government to it, the fact that it comes out in the investigation ought not to be a penalty against the person who made the [whistleblower] call.

On appeal, defendants and the United States as intervenor argue that this ruling is contrary to the plain language of § 3730(e)(4)(B), which requires that an original source have "direct and independent knowledge of the information on which the allegations are based." We agree. Indeed, we squarely rejected this "catalyst" theory in United States ex rel. Barth v. Ridgedale Elec., Inc., 44 F.3d 699, 703 (8th Cir. 1995), when we stated that "direct" knowledge is knowledge "marked by the absence of an intervening agency." Other circuits agree. See United States ex rel. Merena v. Smithkline Beecham Corp., 205 F.3d 97,102 (3d Cir. 2000) ("each claim in a multiclaim [qui tam] complaint must be treated as if it stood alone"). As the Supreme Court recently held in another context, a catalyst theory may not be adopted for policy reasons if it is contrary to the plain meaning of the governing

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[3] Hays bases his claim of voluntary disclosure on his whistleblower letters to DHS, a state agency. In our view, that is further support for our conclusion that the resulting DHS audit reports were public disclosures for purposes of § 3730(e)(4).

statute. Buckhannon Board & Care Home, Inc. v. W. Va. Dept. of Health & Human Resources, 532 U.S. 598, 605-10 (2001).

Thus, we must resolve the original source issue on a claim-by-claim basis. The jury found that defendants committed eleven types of false claims. On appeal, defendants concede that Hays was the original source of one allegation that was then confirmed by the DHS audit -- defendants falsely claimed that apples given as gifts to SFHS employees were a Medicaid-reimbursable food expense. However, Hays has failed to establish that he was an original source as to the other ten claims.

Most of the other claims were not volunteered by Hays in his whistleblower letters to DHS; he cannot be an original source of those claims under § 3730 (e) (4)(B). As to the other claims arguably referred to in his letters, Hays argues that he was a "close observer" of the information provided because he obtained that information from Thomas Conner, SFHS's former finance director who was himself unwilling to come forward as a whistleblower. But such knowledge is neither direct nor independent. "[A] person who obtains secondhand information from an individual who has direct knowledge of the alleged fraud does not himself possess direct knowledge and therefore is not an original source." Barth. 44 F.3d at 703. "[T]o be independent, the relator's knowledge must not be derivative of the information of others, even if those others may qualify as original sources." United States ex rel. Fine v. Advanced Sciences, Inc., 99 F.3d 1000, 1007 (10th Cir.1996).

We conclude that Hays was the original source only of the apples allegation. Therefore, applying § 3730(e)(4)(A), the district court lacked subject matter jurisdiction over the

remaining types of false claims found by the jury. That portion of the $1,680,000 total fine attributable to those claims must be vacated. In addition, as the jury verdict absolved Kay Knock of any liability for the claim concerning apples, the complaint against defendant Knock must be dismissed.

II. What About the Apples?

In addition to challenging the district court's subject matter jurisdiction, SFHS and Hoffman appeal the adverse judgment on the apples claim, raising both liability and penalty issues.

A. Defendants level a three-pronged attack on the jury verdict that SFHS and Hoffman violated the FCA by claiming employee gift apples as a reimbursable Medicaid expense. First, although the DHS audit reports established that improper apple claims were made,[4] defendants argue that Hays failed to prove that any person knowingly submitted false claims. A person acts knowingly for purposes of the FCA if he has actual knowledge of the false information, or acts in deliberate ignorance or reckless disregard of the information's truth or falsity. 31 U.S.C. § 3729(b). But merely erroneous or negligent claims are not actionable under the FCA. See United States ex rel. Quirk v. Madonna Towers, Inc., 278 F.3d 765, 767 (8th Cir. 2002).

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[4] The DHS regulations expressly include as non-allowable costs for nursing and intermediate care facilities "activities not related to resident care such as flowers or gifts for employees." MINN RULES § § 9549.00361, 9553.0036F

After careful review of the trial record, we conclude there was sufficient evidence on this issue. Viewed most favorably to the jury's verdict, the evidence established that (i) Hoffman and the SFHS internal accountants knew employee gifts were not reimbursable under the applicable Medicaid rules; (ii) gift apple invoices for a number of years were entered on SFHS general ledger accounts as "resident food"; and (iii) Hays and at least one other employee asked whether these purchases should instead be entered as employee gifts and were told by Hoffman to continue entering them as food. Defendants countered this showing with evidence that employees who prepared the Medicaid cost reports submitted to DHS were expected to exclude any non-reimbursable items entered in multi-purpose general ledger accounts such as the food account. But there was also evidence this was a haphazard, unsupervised process, permitting the jury to infer that, when Hoffman told employees to enter gift apples in the general ledger as resident food, he knew this would result in Medicaid cost reports that improperly included this item as a reimbursable food expense.[5]

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[5] The knowing violation issue in this case is very close. On appeal, Hays relies primarily on his proof that SFHS personnel initially entered the apples as resident food in the facilities' general ledger accounts. But standing alone, that was clearly insufficient. Food purchased to feed residents is a reimbursable expense, while food purchased for other uses, such as employee gifts, is not. Hays's expert testified that, to properly exclude non-resident food, a facility "either can put it in that raw food column, and then adjust it out, or . . . put it in a nonreimbursable area." Thus, it required proof of a knowing failure to "adjust it out," or reckless disregard of the need to do so, to prove a knowing violation.

Second, defendants argue the district court erred in refusing to instruct that materiality is an element of an FCA violation. We recently confirmed that a showing of materiality is implicit in the FCA, though we did not define "the precise contours" of this requirement. United States ex rel. Costner v. United States, 317 F.3d 883, 887 (8th Cir. 2003). In their reply brief, defendants concede that the false claims were material if they "were capable of influencing the government's payment decision." The district court's instructions included that concept in a definition of materiality. Moreover, the record is clear that the reporting of employee gift apples as a reimbursable food expense was capable of influencing, and did in fact influence, the government's Medicaid reimbursement decisions. Thus, the instructions "taken as a whole and viewed in light of the evidence and the applicable law, fairly and adequately submitted the issues in the case to the jury." Gray v. Bucknell, 86 F.3d 1472, 1485 (8th Cir.1996).

Third, defendants argue they were prejudiced by a number of the district court's evidentiary rulings. After carefully reviewing the record, we find no clear and prejudicial abuse of discretion. See Anheuser-Busch, Inc. v. John Labatt, Ltd., 89 F.3d 1339, 1345 (8th Cir.1996) (standard of review), cert. denied, 519 U.S. 1109 (1997). Limited to the apples claim, the evidentiary contentions are without merit. B. Turning to more difficult issues, defendants argue that Hays failed to introduce evidence supporting the district court's conclusion that 336 false claims were submitted, and that the $1,680,000 penalty violates the Excessive Fines Clause of the Eighth Amendment. We agree with the first contention. 'Therefore, we need not decide the second, though we agree with the Ninth Circuit that FCA penalties are punitive in nature and therefore fall within the reach of the Excessive Fines Clause.

See United States v. Mackby, 261 F.3d 821, 829-31 (9th Cir. 2001).

The FCA. provides that any person who knowingly makes a false claim (or causes one to be made) "is liable to the United States Government for a civil penalty of not less than $5,000 and not more than $10,000." 31 U.S.C. § 3729(a). In determining the number of false claims for which this statutory penalty should be assessed in a particular case, the Supreme Court has cautioned that "we are actually construing the provisions of a criminal statute. Such provisions must be carefully restricted, not only to their literal terms but to the evident purpose of Congress in using those terms." United States v. Bornstein, 423 U.S. 303, 313 n.8 (1976) (quotation omitted). In Bornstein, a subcontractor made three shipments of falsely marked electron tubes to a general contractor who incorporated the tubes into radio kits billed to the government in thirty-five invoices. Rejecting the government's claim that the subcontractor committed thirty-five FCA violations, the Court held "that the focus in each case [must] be upon the specific conduct of the person from whom the Government seeks to collect the statutory forfeitures" and concluded that the subcontractor's three shipments constituted three violations. 423 U.S. at 312-13.

In this case, though the inquiry is fact-intensive, the district court treated the number of false claims as a question of law, which means we review its conclusion *de novo*. The court made its determination based upon the trial record, which was focused on other issues and is woefully inadequate for this purpose. Hays relied primarily on the testimony of Robert Rau, a former DHS auditor who had no firsthand knowledge of how SFHS facilities prepared and submitted requests for Medicaid reimbursement. Based upon his review of the DHS audit reports, Rau opined that the treatment of

employee gift apples as a reimbursable food expense resulted in two hundred false claims for FCA purposes. He arrived at that number by concluding that the apples expense impacted twenty-seven annual Medicaid cost reports, and by assuming that each SFHS facility submitted monthly requests for payment to DHS using "residential service invoice" (RSI) forms. But the trial record contained no SFHS cost reports or RSI forms. Rau admitted that the RSI form is prepared on a per-resident basis, not a per-facility basis. No witness explained the manner and frequency in which SFHS facilities submitted payment requests to DHS in the years in question. And Hays failed to include in the record on appeal the exhibit showing Rau's calculations. On this record, Rau's opinion as to the number of false claims was simply an unsubstantiated guess.

In addition, we have a more fundamental problem with the district court's decision to accept Rau's opinion as to the number of false claims. Bornstein instructs us to focus on "the specific conduct of the person from whom the Government seeks to collect the statutory forfeiture." 423 U.S. at 313. Here, the misconduct was to purchase approximately $6,000 worth of apples, give them to employees during the holiday season, and then falsely claim Medicaid reimbursement for this expense. Medicaid reimbursement is a rate-based regime. A facility's historical costs are recorded on an annual cost report. DHS then uses that report to calculate a payment rate or rates which are applied to all covered services over the following year (disregarding necessary time lags in the complex system). See 42 U.S.C. § 1396a(a)(13)(A); MINN. RULES chs. 9549 (nursing facilities), 9553 (intermediate care facilities). Under this system, a one-time expense for a multi-facility provider may be reimbursed over hundreds or many thousands of claims for reimbursement of services provided to individual residents. Under Rau's analysis, this protracted

method of government reimbursement produces a $1,000,000 penalty (200 claims times $5,000 per claim) that bears no rational relationship to the false claim misconduct -- seeking improper reimbursement for spending $6,000 to purchase apples. Thus, we reject layman Rau's approach to deciding a legal question laced with Excessive Fines Clause implications. "It is [the] conduct of the medical practitioner, not the disposition of the claims by the government, that creates FCA liability." United States v. Krizek, 111 F.3d 934, 940 (D.C. Cir.1997) (rejecting a government number-of-claims theory that produced "an astronomical $81 million worth of [penalties] for alleged actual damages of $245,392"). There remains the question of how we should dispose of the number-of-claims issue. The district court's determination of 336 false claims obviously cannot be upheld because ten of the eleven categories of claims were beyond its jurisdiction. As we have explained, Rau's opinion that there were two hundred false claims relating to apples is unsupportable as a matter of law. In reviewing the documentary portion of the record on appeal,[6] we noted DHS audit reports showing that employee gift apples were claimed by eight SFHS facilities and subsequently disallowed by DHS. The decision to falsely and knowingly claim those apples as a reimbursable expense for each facility was clearly eight false claims for FCA purposes. Therefore, taking into account the district court's judgment that defendants engaged in serious misconduct, we will impose the maximum $10,000 penalty per violation and reduce the total FCA penalty to $80,000.

The judgment of the district court is reversed in part, and the case is remanded with directions to enter a modified final

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[6] The record on appeal apparently omits many trial exhibits, but any blame for that must fall on Hays, who has the burden of proof on this issue.

judgment in which (i) the penal set forth in paragraph 1 of the court's order for judgment dated August 20, 2001 is changed from $1,680,000 to $80,000, and (ii) plaintiff s claims against defendant Kay Knock are dismissed with prejudice. Appellants' motion to strike is denied as moot.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS,
EIGHTH CIRCUIT.

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
97-CV-1656 (JMR/FLN)

Patrick M. Hays, and United States of America ex rel. Patrick M. Hays	)	
v.	)	ORDER
Luverne Hoffman; Kay Knock; St. Francis Health Services of Morris, Inc.; Villa of St. Francis Nursing Home, Inc.; Browns Valley Health Center, Inc.; Franciscan Health Center, Inc.; Leisure Hills Health Center, Inc Prairie Community Services, Inc.; Prairie Community Waivered Services, Inc.; Prairieland Management Services, Inc.; and St. Louis Riverview Homes, Inc.	)	

After a trial by jury, defendants were found to have submitted false claims in an effort to defraud the United States.[1] Although the jury determined the factual question of whether false claims were submitted, it did not determine the legal question of how many false claims were involved.[2] That

[1] The jury rendered its verdict on December 5, 2000.

[2] The False Claims Act ("FCA"), 31 U.S.C. 3729-3733, mandates a fine between $5,000 and $10,000 for each false

question was referred to the Honorable Franklin L. Noel, United States Chief Magistrate Judge, who issued a Report and Recommendation on April 26, 2001, finding that defendants submitted 336 false claims. Defendants timely filed their objection to the Report, pursuant to Local Rule 72.1(c)(2).

The Court has made a de novo review of the record herein, and finds the Magistrate correctly applied prevailing law to the facts of this case. Accordingly, the Court adopts the Magistrate's calculation of the number of false claims.

By doing so, a concern of constitutional dimension is raised: whether a fine ranging from $1.68 million to $3.36 million violates the Excessive Fines Clause of the Eighth Amendment to the United States Constitution.[3] Defendants, understandably, claim that it does. Plaintiff, equally understandably, is confident that even the maximum fine passes constitutional muster.

The FCA requires the Court to impose a fine ranging between $5,000 and $10,000 for each false claim. 31 U.S.C. § 3729(a). Imposition of the fine is not discretionary. See "United States v. Advance Tool Co., 902 F. Supp. 1011, 1018 (W.D. Mo. 1995). However, constitutional concerns trump even statutory mandates, and this Court must independently ensure that any fine imposed comports with the demands of the Eighth Amendment. Id.; see also United States ex rel.

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claim, making the precise number of false claims involved in this case a necessary question.

[3] "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." U.S. Const. amend. VIII.

Smith v. Gilbert Realty Co., 840 F. Supp. 71 (E.D. Mich. 1993).

As an initial matter, the Court notes it is not at all certain that the Excessive Fines Clause even applies. The history of the Clause reveals it "was intended to limit only those fines directly imposed by, and payable to, the government." Browning-Ferris Industries v. Kelco Disposal, Inc., 492 U. S. 257, 268 (1989). This comports with the Eighth Amendment's overall purpose: to limit "the steps a government may take against an individual, whether it be keeping him in prison, imposing excessive monetary sanctions, or using cruel and unusual punishments." Id. at 275.

Certainly the Excessive Fines Clause protects individuals against the government's prosecutorial power; but whether its protection extends beyond individuals to corporations, and whether it extends beyond direct government action to private qui tam actions, is less certain. Id, at 276 n.21 (leaving open the question whether the Excessive Fines Clause applies to qui tam actions); Id. at 283-85 (O'Connor, J., concurring in part and dissenting in part) (addressing the open question of whether the Eighth Amendment applies to corporations).

Here, the Court faces a qui tam action brought by an individual on behalf o f the government, against a variety of individual and corporate defendants. The government, after being given the option, declined to intervene, and allowed the entire case to be assumed and tried by the individual plaintiff. Whether the Excessive Fines Clause actually applies to any fine imposed under these circumstances, is murky at best. The Court need not resolve the scope of the Eighth Amendment's reach, however, for whether or not the Excessive Fines

Clause applies, the presumptive fine is not excessive as a matter of law.

A fine is excessive under the Constitution if two conditions are met: (1) the payment to the government constitutes punishment for an offense; and (2) the payment is grossly disproportionate to the gravity of that offense. United States v. Bajakajian, 524 U.S. 321, 327-27, 334 (1948). Fines imposed under the FCA are recognized, at least in part, to be punitive. United States v. Bornstein, 423 U.S. 303, 309 n.5 (1976) ; see also United States v. Mackby, 243 F.3d 1159 (9th Cir. 2001) . The Court thus focuses its inquiry on the second prong -- whether the presumptive fine here would be grossly disproportionate to defendants offense.
"The touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the [fine] must bear some relationship to the gravity of the offense that it is designed to punish." Bajakajian, 524 U.S. at 334. The jury here weighed the evidence and found defendants had engaged in 11 separate schemes to defraud the government, each involving multiple false claims. The jury further decided defendants retaliated against plaintiff by firing him for reporting the intended fraudulent activities. Although the jury found the schemes did not result in any actual loss to the government, it awarded plaintiff $771,736 for lost income resulting from his retaliatory discharge.[4]

Defendants now contend a fine exceeding one million dollars, in a case where the government has suffered no loss,

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[4] The jury awarded plaintiff $171,736 in past lost wages and benefits, and $428,264 in future lost wages and benefits. Under the FCA, plaintiff's back: pay damages are doubled. 31 U.S.C. 3730(h).

is grossly disproportionate to the offense. Defendants are wrong. Their argument ignores the reality of the harm caused to plaintiff and the attempted harm to the United States. It also ignores the fact that monetary harm would have redounded to the government but for plaintiff's whistleblowing, which alerted government auditors to defendants' activities.

The jury determined that defendants engaged in a deliberate scheme, broad in both scope and duration, to pilfer from the government fist for their own benefit. They attempted to conceal their illegal billing practices by discharging plaintiff when he reported their financial improprieties. Defendants' illegal conduct forced the government to engage in a lengthy audit process to reconcile the various irregularities, and forced plaintiff to pursue legal recourse for his retaliatory discharge. The jury awarded plaintiff substantial personal damages as recompense for the harm caused by defendants as they pursued their scheme to defraud the government. The jury's verdict makes clear that defendants' conduct resulted in harm both real and substantial. Admittedly, the bulk of the injury was suffered by plaintiff, not the government. But the fact that there was no actual dollar loss to the government does not preclude a fine being imposed on defendants. The FCA does not require monetary loss as a prerequisite to the imposition of a fine. See U.S. ex rel. Haaood v. Sonoma County Water Agency, 929 F.2d 1416, 1421 (9th Cir. 1991). Defendants' situation is equivalent to a bank robber being apprehended before departing the bank -- while there is no dollar loss, the full force of the criminal law applies, and a fine can constitutionally be imposed as part of the penalty. The Court cannot find the mandated fine disproportionate to the gravity of defendants' offense. Defendants' wrong consisted of submitting false claims, and they did so repeatedly. The fact

that the false claims did not succeed does not ameliorate the offense.

Defendants will be assessed $5,000 per false claim, resulting in a total fine of $1,680,000.[5] The Court has assessed the least amount allowed by statute in recognition of the de minimus loss to the government, which was deprived of time, but not money, as a result of defendants' fraud. The Court awards to plaintiff, as the original source o f the information and the prime mover of the lawsuit, 30 percent of that fine. 31 U.S.C. 5 3730(d)(2).

Accordingly, IT IS ORDERED that:

1. Pursuant to 31 U.S.C. § 3729(a) , defendantsare fined $1, 680, 000, of which 30% shall be paid to plaintiff Patrick Hays. Defendants are jointly and severally. liable for that amount.[6]

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[5] The Court notes that the fine assessed is a multiplier of 2.2 times the damages the jury found were suffered by plaintiff. As the Supreme Court has noted, "We need not, and indeed we cannot, draw a mathematical bright line between the constitutionally acceptable and the constitutionally unacceptable that would fit every case. We can say, however, that general concerns of reasonableness...properly enter into the constitutional calculus." Pacific Mutual-Life Ins, Co. v. Haslip 499 U.S. 1, 18 (1991) (quoted in BMW v. Gore, 517 U.S. 559, 582-83 (1996)). The Court considers a fine amounting, essentially, to double damages to be well within the bounds of reasonableness and proportionality.

[6] A defendant's ability to pay a fine is a factor under the Excessive Fines Clause. United States v. Lippert, 148 F.3d 974, 978 (8th Cir. 1998). None of the defendants, corporate

2. Pursuant to 31 U.S.C § 3730(h), defendants shall pay plaintiff Patrick Hays $771,736, plus interest on the back pay amount.

3. Plaintiff is entitled to costs and reasonable attorney's fees in an amount to be determined by the Magistrate Judge.

LET JUDGMENT BE ENTERED .ACCORDINGLY.
Dated: August 20, 2001

s/JAMES M. ROSENBAUM
United States District Judge

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or individual, contend they are unable to pay, merely that they are unwilling to do so.

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
97-CV-1656 (JMR/FLN)

Patrick M. Hays;	)
	)
v.	) VERDICT
	)
Luverne Hoffman; Kay Knock; St. Francis Health Services of Morris, Inc.; Villa of St. Francis Nursing Home Inc.; Browns Valley Health Center, Inc.; Franciscan Health Center, Inc.; Leisure Hills Health Center, Inc.; Prairie Community Services, Inc.; Prairie Community Waivered Services, Inc.; Prairieland Management Services, Inc.; and St. Louis Riverview Homes, Inc.	)

We, the jury, answer the questions submitted to us as follows:

1. Claims concerning apples:

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(a) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

X Yes ___No

(a) If you answered "yes" to either of the two questions above, what were the measurable damages sustained by the United States?

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2. Claims concerning van swap by St. Louis Riverview Homes, Inc.:

(a) Did defendant Kay Knock violate the False Claims Act?

___Yes X No

(b) Did defendant Luverne Hoffman violate the False Claims Act?

___Yes X No

(c) Did defendant Kay Knock conspire to violate the False Claims Act?

___Yes X No

(d) Did defendant Luverne Hoffman conspire to violate the False Claims Act?

___Yes X No

(e) Did defendant St. Louis Riverview Homes, Inc. violate the False Claims Act?

___Yes X No

(f) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

___Yes X No

(g) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

$_____

3. Claims concerning condominium timeshare:

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(b) Did defendant Kay Knock violate the False Claims Act?

___Yes X No

(c) Did defendant Luverne Hoffman conspire to violate the False Claims Act?

X Yes ___No

(d) Did defendant Kay Knock conspire to violate the False Claims Act?

___Yes X No

(e) Did defendant St. Louis Riverview Homes, Inc. violate the False Claims Act?

___Yes X No

(f) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

X Yes ___No

(g) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

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4. **Claims concerning company vehicle use by defendant Luverne Hoffman:**

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(b) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?'

X Yes ___No

(c) If you answered "yes" t o any of the questions above, what were the measurable damages, if any, sustained by the United States?

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5. **Claims concerning St. Louis Riverview Homes' management fees:**

(a) Did defendant Kay Knock violate the False Claims Act?

X Yes ___No

(b) Did defendant Luverne Hoffman violate the. False Claims Act?

X Yes ___No

(c) Did defendant Kay Knock conspire to violate the False Claims Act?

___Yes X No

(d) Did defendant Luverne Hoffman conspire to violate the False Claims Act?

___Yes _X_No

(e) Did defendant St. Louis Riverview Homes, Inc. violate the False Claims Act?

_X_Yes ___No

(f) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

_X_Yes ___No

(g) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

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6. Claims concerning Specialized Transportation charges:

(a) Did defendant Luverne Hoffman violate the False Claims Act?

_X_Yes ___No

(b) Did defendant Kay Knock violate the False Claims Act?

_X_Yes ___No

(c) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

_X_Yes ___No

(d) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

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7. **Claims concerning Specialized Transportation's use of a Prairie Community Services Lakewood Home van:**

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(b) Did defendant Kay Knock violate the False Claims Act?

X Yes ___No

(c) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

X Yes ___No

(d) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

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8. **Claims concerning dietary consulting:**

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(b) Did defendant Kay Knock violate the False Claims Act?

X Yes ___No

(c) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

X Yes ___No

(d) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

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9. Claims concerning Prairie Community Service's maintenance workers:

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(b) Did defendant Kay Knock violated the False Claims Act?

X Yes ___No

(c) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

X Yes ___No

(d) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

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10. Claims concerning Everstrong Construction Co. fire payment:

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(b) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

X Yes ___No

(c) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

$ Ø

11. Claims concerning the Steiger payment:

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(b) Did defendant Luverne Hoffman conspire to violate the False Claims Act?

___Yes X No

(c) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

___Yes X No

(d) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

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12. Claims concerning grant money and the Hoffman Home van:

(a) Did defendant Luverne Hoffman violate the False Claims Act?

X Yes ___No

(b) Did defendant St. Francis Health Services of Morris, Inc., or any of its subsidiaries, violate the False Claims Act?

X Yes ___No

(c) If you answered "yes" to any of the questions above, what were the measurable damages, if any, sustained by the United States?

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13. Did defendant Luverne Hoffman retaliate against plaintiff Patrick Hays in violation of the federal False Claims Act?

X Yes ___No

14. Did defendant Villa of St. Francis Nursing Home, Inc. retaliate against plaintiff Patrick Hays in violation of the federal False Claims Act?

___Yes X No

15. Did defendant St. Francis Health Services of Morris, Inc. retaliate against plaintiff Patrick Hays in violation of the federal False Claims Act?

X Yes ___No

16. Did defendant. Villa of St. Francis Nursing Home, Inc. retaliate against plaintiff Patrick Hays in violation of the Minnesota Whistleblower law?

___Yes X No

17. Did defendant St. Francis Health Services of Morris, Inc. retaliate against plaintiff Patrick Hays in violation of the Minnesota Whistleblower law?

X Yes ___No

Note: Answer the following question about damages to Patrick Hays only if you answered "yes" to any of the retaliation questions 13 through 17 above.

18. What amount of damages do you find that plaintiff Patrick Hays sustained?

(a) Lost income and benefits to date: $171,736.00

(b) Loss of future income and benefits: $428,264.00

(c) Emotional distress: $ Ø

Dated: December 5, 2000

s/Foreperson

THE MORRIS TRIBUNE
Thursday, February 13, 1997

Some operating expenses questioned
SFHS plans to appeal audit findings

Apparently it all depends on your perspective whether you consider the results of a recent audit of St. Francis Health Services significant.

In one scenario, the Morris-based manager of a number of nursing homes and group homes around the state will have to reduce its cost of doing business by hundreds of thousand of dollars. In another scenario, only some relatively minor book-keeping adjustments will be made.

The state's Department of Human Services conducted what one auditor characterized as a random field audit last summer and fall of St. Francis Health Services and the more than 20 facilities it manages. Locally, the best known facility is the Villa of St. Francis nursing home.

The adjustments to the business costs claimed by SFHS fall into three broad categories: reducing the charges made by SFHS's for-profit businesses to its nonprofits; reallocation of salaries and labor costs; and disallowing costs not legitimately related to doing business.

Among other things, the DHS field auditor suggested a pattern of St. Francis' for-profit businesses over-charging the nonprofit entities for services performed. In addition, a substantial amount of expenses claimed to be necessary for operating the facilities were disallowed by the auditor.

The DHS conducts "desk audits" annually, which are done

at DHS offices in St. Paul using cost information submitted by nonprofit nursing facilities throughout the state. The facilities' rates, which are determined by the DHS, usually are set based on the information provided, On occasion, DHS personnel will also conduct a "field audit" by visiting facilities and going over the books at the site. That's what happened with St. Francis Health Services.

The DHS field audit which became public a little over two weeks ago was for the fiscal years ending September 30, 1994 and September 30, 1995. The auditor concluded that SFHS's for-profit subsidiaries over-charged its nonprofits by nearly $200,000 during that time.

According to Minnesota law, if a for-profit business provides services for related nonprofits, the for-profit business must demonstrate it does at least 50 percent of its business sales with unrelated businesses. If not, the for-profits cannot charge the related nonprofits more than the actual cost of the service.

SFHS's for-profit subsidiaries did just that, however, according to the audit.

Prairie Land Management Services (PLM) is a for-profit subsidiary of SFHS. Among its businesses are laundry and housekeeping services; in fact, the laundry service is located in the basement of the Villa. From October, 1993 to October, 1995, the auditor determined that about two-thirds of its business was done with the Villa, charging 30-32 cents per pound for laundry when the actual cost was only about 22 cents per pound. The result was an overcharge of about $115,000, according to the auditor.

The auditor also stated that PLM's housekeeping service

had over-charged the Villa by about $57,000 during the two-year period.

At the hear of the auditor's conclusion regarding the laundry service was his determination that revenue from PLM's two Laundromats and car wash should not be included in total revenue to determine the 50-percent rule because they are "dissimilar operations." If the revenue from those operations are included, PLM would meet the 50 percent rule.

St. Francis Health Services' CEO Luverne Hoffman disputed the auditor's disallowance of the laundromats' revenue.

"If you're operating a business, laundry income is laundry income," he maintained. "That's the issue. We've been doing it for years."

Hoffman backed up his statement by saying that an audit done two years ago found no problem with including the laundromats' income in determining the 50 percent rule.

In fact, Hoffman seemed surprised that anyone would be curious about the results of the recent audit, saying that DHS audits of nursing homes are routine.

"Really, it's nothing," he commented. He also noted that all the issues raised by the current auditor are subject to appeal, which SFHS intends to do. In fact, Hoffman said the auditor's superiors have assured him that SFHS would win at least some of the appeals. He added that some issues that SFHS appealed at the last audit still have not been resolved.

One appeal from the most recent audit no doubt will involve a finding made about dieticians' hours.

According to the audit, during the October, 1993 to October, 1995 period, Home Care Service Options provided dietary consulting to several St. Francis-owned facilities, including the Villa, Prairie Community Services and Prairie Community Waivered Services. In fact, based on sales, the auditor estimated that Home Care Services Options' dietician program did between 70-80 percent of its business with related parties, yet charged them more than the actual cost of the service.

In addition, the auditor found large discrepancies between the billed hours and the actual payroll hours. The audit indicates that in one month alone, January 1994, Home Care Service Options billed related facilities for 153 hours, yet the payroll reflected only 47 hours worked.

All together, more than $11,000 of costs claimed by the nonprofits for dietary consulting were disallowed for the two-year period. Regarding the apparent over-billing, the auditor commented that an "other finding" may be made regarding the billing for hours in excess of the actual hours worked.

Hoffman, who said he had not gone through the entire audit yet, appeared to be puzzled about the finding about the dietary consulting. He acknowledged that dietary consulting services are provided, but not through Home Care Service Options. He added that dieticians' fees are a flat fee billed monthly.

In addition to the supposed over-charges, nearly $170,000 in other operating costs claimed by St. Francis Health Center between October, 1993 and October, 1995 were disallowed by the DHS auditors.

A partial list of those disallowed costs either indicates the zeal of the auditors, the attempt of SFHS to recapture some questionable expenses, or both.

Among the expenses disallowed or reduced:

- $24,500 in rent paid to the Villa of St. Francis. According to the auditor, when SFHS offices were located in the Villa, that area was already included in the Villa's property-related payment rate. The auditor concluded that allowing SFHS to claim the rent as an operating expense would result in a duplication of payment for the space.

- $15,580 for a deferred compensation/key man life insurance for Hoffman. The law allows life insurance for owners or officers only if comparable insurance is provided to all employees, which it apparently was not.

- $2,371 for Hoffman's personal use of a St. Francis vehicle.

- nearly $17,000 in legal fees charged for property purchases, lawsuits, Service Options for Seniors incorporation, and other legal work not considered part of the legitimate costs of operating SFHS.

- $2,100 in management fees paid by St. Louis Riverview Home near Duluth were offset against SFHS costs because the actual expense for services was not known.

- $990 in advertising expenses paid to KMRS radio. State law allows nursing homes to advertise only in

the yellow pages.

- $384 airplane ticket for Hoffman's daughter, who accompanied him to a conference in Washington, D.C.

Additionally, a number of employees who split their time among the various nonprofit and for-profit entities did not sufficiently document their time at the various facilities to the satisfaction of the DHS auditor. This resulted in a redistribution of over $90,000 in wages over the two-year period.

The total amount in dispute between the Department of Human Services and St. Francis Health Services and its subsidiaries is not summarized in any one particular place in the audit. Even if that amount runs into the hundreds of thousands of dollars, as it appears to, it would represent only a fraction of the total operating costs of the multimillion dollar SFHS conglomerate. Nonetheless, it is a significant amount of taxpayer money that is caught in the tug of war.

SFHS has 60 days to appeal the results of the audit, and based on Hoffman's comments, it may be years before some issues are resolved. At this point, St. Francis Health Services has not been accused of any wrongdoing.

Regarding appeals, Hoffman concluded, "We just want our chance to talk to somebody. If we're doing something wrong, we don't know that yet."

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
SIXTH DIVISION
CIVIL FILE NO. 98-1656 JMR/FLN

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Patrick M. Hays, et al.,

Plaintiffs,

vs.

AFFIDAVIT
OF
JOHN G. BURNS

Luverne Hoffman, et al.,

Defendants.

****

John G. Burns states the following under oath:

1. I have been employed as an auditor for the Department of Human Services for over 14 years. For over nine years, I have been a Field Audit Supervisor. My resume and my February 14, 1999 three page description of employment experience is attached. I was the Field Audit Supervisor for the field audit that was conducted on St. Francis Health Services and its subsidiary organizations, the Rule 50 nursing homes and Rule 53 Intermediate Care Facility Mentally Retarded (ICRMR) homes, in the summer of 1996.

2. For the 1996 field audit of St. Francis Health Services and its subsidiaries, I supervised two other DHS auditors, Robert Cooke and Peter Deng. I also

performed some of the actual audit work.

3. The actual field audit work in 1996 began in about mid-May. Before that Patrick Hays had sent several letters advising us of what he believed to be illegal conduct by officials at St. Francis organizations. These letters were Provided from February to April, 1996. These letters caused the field audit of St. Francis in the summer of 1996. Desk audits of cost reports are performed each year, on each annual cost report submitted by nursing homes or group homes. Field audits happen less frequently. Desk audits occur with the auditor reviewing papers that are submitted font the management of the homes. These desk audits are performed at our DHS office in St. Paul, on cost reports and other specified documents that are submitted by the management of the homes. Field audits consist of a review of all of these desk audit type documents, but also consist of on-site examinations of the homes, the premises and equipment, many more financial and business records and discussions with personnel. In the case of a multiple corporate entity like St. Francis, these field audits take months to complete. A field audit was performed of St. Francis in 1994. It is not common to have a field audit by our DHS agency occur within two years of another field audit. The St. Francis organization may have gone for a good number of years without another field audit if it hadn't been for the complaint letters of Patrick Hays.

4. The incorrect claims of St. Francis Health Services and its organizations were discovered in the field audits as a result of the originating complaints by Patrick Hays, and what our desk auditors had learned

in the previous annual desk audits. In the early stages of conducting the field audit, I also personally interviewed Patrick Hays to obtain more information to help us in the field audit.

5. The cost reports are legally required to be provided by nursing homes and group homes (ICFMRs), pursuant to state law, as the initial step in obtaining government reimbursement. Reimbursement costs can't be claimed unless a cost report is submitted. The government provides state and federal money to nursing homes and group homes based upon the expenses itemized in these cost reports. The managing officers of these businesses that receive government money are legally required to know the accuracy, and certify the accuracy, of these cost reports. Each line item on these cost reports is a claim for money to the state and federal government, unless it is a line on the report that is designated as a non-reimbursable expense item. In order for the businesses to receive the state and federal money to operate their nursing homes or group times, they need to make the claim for the expense on the-cost report, and the reimbursement rate paid by the government is based upon the amount that they place in each line item of the cost report. Our DHS agency disallows costs claimed in cost reports by providers where the costs claimed are incorrect, meaning not in compliance with the law.

6. In the 1996 audits, there were repeated violation of the 50% related party rule, repeated violations of time keeping requirements for employees who worked at more than one business, gifts to employees improperly claimed as legitimate expenses, and a transportation van owned by a non-profit of St. Francis Health

Services being used by a private, for-profit company owned by the CEO of St. Francis and the administrator of the for-profit companies of St. Francis. I can also state that in all my years of doing audits of nursing homes, I have never seen anything like the check written back to St. Francis Health Services by the former owner of a nursing home that sold the home to St. Francis, the check being over $400,000.

7. The laws relating to time record requirements for shared employees are found in the legal Rules 50 and 53 (DHS Rules chapters 9549 and 9553, respectively), the instruction manuals for providers on these rules that are issued by DHS, and DHS bulletins 91-64A and 92-64A on time record requirements, which were issued in 1991 and 1992. Although there was a new time record keeping bulletin issued in 1995 by DHS, this was not used for our field audits or desk audit for the cost years 1994 and 1995 involved in this case.

Dated: 11-29-99

s/John G. Burns

***

Q. And that rate, then, is the amount of money that Medicaid then is paying to the nursing home or group home?

A. Yes. It's a per diem, amount, per day.

Q. Now, otter this rate is set, the nursing home or group home gets the money, gets the Medicaid money, right?

A. Yes.

Q. And how do they do that?

A. The group home or nursing home will bill the state and then a warrant or check will be issued.

Q. Okay.

A. To the home.

Q. And, umm, is that billing the state called a payment request?

A. Umm, you could call it that way.

Q. And how often are these payment requests made by the nursing home or group home?

A. Usually monthly.

Q. So twelve times a year?

A. Yes.

Q. All right umm, now, let's look at how this works for a system like St. Francis's, ah, and you're familiar with you did the t field audit?

A. Yes.

Q. Umm, and St. Francis has a central office, a number of nursing homes, a number of group homes, and then companies

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were at Browns Valley Nursing Home as well?

A. Yes.

Q. Now, did you prepare a summary, umm -- excuse me a minute. Did you, at, examine how many cost reports these gift apple claims ended up on?

A. Yes.

Q. And how many cost reports was that?

A. It impacted 27 Cost reports.

Q. And did you examine how many umm, the number of payment requests that had these gilt apples within it?

A. With the assumption that every month that they billed the Medicaid program, we would call, one claim, it would have impacted 200 claims.

Q. Now, can you explain for the jury, umm, how that would be, ah, now you would arrive at that, ah, first the number of cost reports, and start out by saying, were some of the girt apples purchased actually through the central office?

A. Yes.

Q. Okay. And now would that impact the cost reports

for the nursing homes and group homes?

A. They took the expenditure that they mad tar those apples and they allocated 'em to the various, what I call ICFMR facilities, the group homes.

Q. Okay.

A. So what I did is I counted the rate adjustments made, or the rate disallowances made by the department through their desk and field audits and came up with the 27 reports that were Impacted.

Q. So those would have been cost reports submitted to the Department of Human Services by the group homes and by the nursing homes?

A. Yes.

Q. All right. Correct? And then because the term trickle down was used, because these expenses from central office trickle down into here and were reported on cost reports, each of them, homes would have submitted monthly bills for payment, right?

A. Yes.

Q. And within that could be a quite minute amount for the gift apples?

A. That's true.

Q. Now, did I ask you to prepare a summary based on these audits on the amount of the federal share of

dollars, ah, going into this false claim had on gift apples?

A. Yes.

Q. Showing you what's marked at Exhibit 241, is this two-page exhibit?

A. Yes.

Q. And is that a calculation that you put together to arrive at just what the federal share payment was on the

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A. No.

Q. Okay.

A. Could I explain that?

Q. Not now, Incidentally, do you recall Mr. Wojtalewicz's questions concerning these payment requests that were submitted by the nursing homes and the group homes?

A. Yes.

Q. Are you referring to the residential service invoices?

A. Yes.

Q. Okay. And for each of your calculations on these, you would say that there would be one per month

per facility; is that right?

A. That's correct.

Q. Well, that's not correct, is it, Mr. Rau? Isn't it true that nursing homes submit residential service invoices one per resident per month?

MR. WOJTALEWICZ: objection to the from of the question, argumentative

THE COURT: You may answer, it you're able.

THE WITNESS: They do bill by resident, but they send in one bill, either paper bill or electronic hill.

BY MS. NEWBERG:

Q. I'm asking you how many residential service invoices a nursing home sends in a month.

A. I'd maintain it's one.

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February 23, 1996

Department of Human Services
Medicare Fraud Division
Attn: SIRS
444 Lafayette Road
St. Paul, MN 55155-3851

Dear S IRS ,

You are being notified that Medicare /Medicaid Fraud is taking place at St. Francis Health Services/Villa of St. Francis (245262-Medicare) (0026546-Medicade in Morris, MN. Federal ID Number 23-76-25-632.

1. Management fees from St. Francis Health Services (SFHS) and Prairie Land Management Services (PLMS) Dustbusters were disallowed (SFHS - $60,000) (PLMS - $76,000) by Medicaid. These fees were reduced to COST on Medicaid Cost Reoort but are not reduced on Medicare Cost Report. These fees were not paid back to the Villa of St. Francis (VOSF) by PLMS. It is a FOR-profit company making excessive profits from a NON-profit company. These fees continue to inflate every year. Both companies are owned by SFHS.

2. Specialized Transportation (FOR-Profit) owned by SFHS has a captured market in the transportation Villa residents. was ordered never to use another company, even when necessary (ie: Medivan). This is against the Safe Harbor Law.

3. Staff paid by NON-profit companies are doing work for FOR-profit companies. Their time charged to MA

projects.

4. Hoffman Home (group home) in Morris was a Medicaid project. Everstrong Construction on gave a $50,000, kickback to Luverne Hoffman (CEO of SFHS and member of all Boards of Directors). Luverne Hoffman then released a lien he had against Everstrong Construction from a project: they had done for SFHS in Redwood Falls. The total building cost was turned in to Medicade. First American Bank formerly the Morris State Bank has the records of this and the release of the lien in Redwood Falls should be in the court t records.

5. Luverne Hoffman owns Des Apfel Haus an apple orchard. Luverne 'sells' apples, apple chips and apple juice to many of the organizations under SFHS, as GIFTS, at an inflated price. The accounting personnel are then ordered to put the costs of these apple products under "Food" so that they are reimbursed. This has been going on for several years, These products are being made in a barn in a non-commercial kitchen.

6. Administration and Professional Directors in the group homes under SFHS are "advised" as to where to charge their salaries so that they are reimbursable under Medicaid.

I would strongly suggest that you do a complete audit of the books of St. Francis Health Services, et. al. Please contact me if you have any questions.

Sincerely,

Patrick M. Hays (former Adm. of VOSF)
10 Pomme de Terre Lane
Morris, MN 56267
(612) 589-4297
cc: Attorney General Hubert H. Humphrey III 102 State Capitol
St. Paul, MN 55155

April 11, 1996

Ms. Elaine Dufresne
Department of Human Service
444 Lafayette Road
St Paul, MN 55155

Dear Ms. Dufresne,

I want to take the time to thank you for your letter March 13, 1996, acknowledging the information that I sent to the Department of Human Services. I have been terminated from St. Francis Health Services employment for approaching Board of Directors on some of the following activities of Luverne Hoffman and hence, I am seeking legal advice under the Whistle Blower Statute. Additionally, I wanted to inform you of more items that DHS should be aware of. Elaine, under GROUP HOMES #5 - This should ring a bell with you!!!

I have enclosed copies of document and pictures that may assist you in "discovering" some of the fraud under the auspices of SFHS!

The CEO of St. Francis Health Services (SFHS) directs and manages in methods that would shock the normal working class. Mr. Hoffman runs all related companies employment policies as "employment at will" That is "his will". If an employee does not follow his direction, they are terminated or conditions are made so impossible for them, they are forced to resign. Thus, all employees, Department heads, Supervisors, and Administrators are not allowed to make their own decisions or determine their own course of action. This work environment results in the following:

CODES: SFHS - St. Francis Health Services
VOSF - Villa of St. Francis
BVHS - Browns Valley Health Center
FHC - Franciscan Health Center
LHHC - Leisure Hills Health Center
PLMS - Prairie Land Management Services
PWOM - Pioneer West of Morris*
PCS - Prairie Community Services
PCWS - Prairie Community Wavered Services
SLRH - St Louis Riverview Home*

*FOR Profit

CENTRAL OFFICE: "ST. FRANCIS HEALTH SERVICES OF MORRIS"

1. The central office costs consists of three levels of supervisors allocating and charging their time to the Medicaid/Medicare certified Nursing Homes and Group Homes.

First of all, there is Mr. Luverne Hoffman (CEO) who spends the majority of his time developing new business; not related to Medical Assistance such as managing St Louis Riverview Homes, Inc., picking apples and pruning his private orchard His latest project is a three-phase Assisted Living Complex which he has been working on for at least two years now.

Second, there is Mr. Bruce Prause, Director of Operations, who supervises the Administrators.

Third, three is Kay Knock who is the Vice president of the

FOR-profit companies called Prairie Land Management Services, Inc. and Pioneer West of Morris, Inc. Ms. Knock, for the past four years or so has directly charged her time to the nursing homes as Director of The Villa of St. Francis, Director of Browns Valley Health Center, Director of Franciscan Health Center and Director of Leisure Hills Health Center. The majority of the time Ms. Knock does not go near these facilities! Ms. Knock charges her time to the nursing homes so her for-profit companies do not have to pay for it. I would suggest you check, her time cards.

How can the DHS allow three levels of supervisors above the Administrators to be charged to the M.A. Program? Isn't there any relationship of costs to the benefits received by the resident or can Mr. Hoffman continue to build his empire on the backs of the M.A. Program?

2. These is and has been a special relationship between the senior Administrators and SFHS. They own a company called St. Louis Riverview Homes, Inc. (Brookston, MN), (SLRH), a complex of two Rule 36 Group Homes. Don't you find it funny that there is no allocation of costs from the central office to the Riverview Homes? If one would check the telephone bills from both locations, you would find that there is considerable management time (also Property Insurance (1995) listed location and the largest claim from this location) being used for management of SLRH. Additionally, there are corporate dollars "loaned" to SLRH. See enclosed invoice and documents. Many items have disappeared from the Nursing Homes and Group Homes to furnish a privately owned for-profit company (SLRH). Owners: Luveme Hoffman, Kay Knock, Mary Garmer previous Adm. of the VOSF, Sandy Lenertz former COO

Group Homes, and Kristine Carr former Director of Finance SFHS. Some of the items that have disappeared include used dining room tables from the VOSF, used teacher lounge cabinets from Longfellow School (now the home office of SFHS) and a new vehicle paid for under the M A Program (Westwood Group Home, Redwood Falls, MN). See enclosed letter. One day, Mr. Hoffman borrowed Dick & Gloria Henriksen's horsetrailer (he is the van driver for Specialized Transportation and she is the manager of Dustbusters and are both employed by Kay Knock) and loaded up on furniture items and headed for Brookston.

3. Mr. Hoff man buys a new vehicle each year for his personal/business use. The majority of the miles on these vehicles are for apple delivery. Guess what? He really likes minivans. One can take out the seats for more bushels of apples! Needless to say, all of these personal use costs are mainly paid for by the M.A. Program and he doesn't even receive an IRS 1099 to increase his taxable income.

4. The building depreciation on the Corporate Books is for the time share condominium in Lake Tahoe, Nevada. (This. is asset number 201, see list) It was purchased by the Corporation but in reality is in Luverne and Mary Hoffman's name. Does the M.A. Program pay for this, too? This must be a perk!!!

5. Mr. Hoffman is also a big collector of "Red wing" crocks. Guess who pays for the expensive ones! Check out asset numbers 673, 699 and 706 on the VOSF books and asset number 303 on the SFHS books!

NURSING HOMES

1. The Villa of St Francis is forced to do business with Prairie Land Management Services - Laundry and Housekeeping and Dietary Consulting Services. Even to the extent of almost $80,000 disallowance by DHS in the 711195 rate year. The VOSF has to be one of the highest cost facilities in the State of Minnesota in Laundry and Housekeeping. Not only does the VOSF get charged outrageous prices, Hoffman/Knock have set up a COMMERCIAL LAUNDRY in the basement of the VOSF. Do you have any idea what water and sewer charges cost? I can tell you the square foot cost allocation does not cover it! Housekeeping rates for the VOSF are determined by Ms. Knock. Needless to say, the VOSF gets charged $15.00 for some Housekeeping services while the same service is provided downtown and in private homes at $8.50. Why does the Medicaid/Medicare Program get charged so much more than commercial/private individuals for the same work? The Dietary Consultant costs in the Nursing Homes and Group Hones are related party costs and do not meet the 50% Rule on non-related parties In fact, their only customers are themselves

2. The Maintenance men at the VOSF have had to work at ALL Morris owned locations such as group homes and the VOSF paid for it! The Social Worker and Minister of SLRH charged their employment to the FHC in Duluth - convenient? Where do they actually work?

GROUP HOMES:

1. Maintenance men at the Rule 53 Group Homes fix everything in the area, including the for-profit Laundromat. See Picture #4. The brown van is used by Wes Hoffman (Luverne Hoffman's brother) and the gray van is Dwight Gades. Guess who pays for their vehicles and time?

2. Mr. Hoffman likes to have Rule 53 and Wavered Group Homes in the same town. Guess why? Watch out for homes in Morris, Alexandria and Spider. The Administrators and Program Directors complain about why they are "told" to charge their time to Rule 53 Homes.

3. Vehicles are paid for under the M.A. Program (Rule 53 Group Homes) and by corporate (SFHS) and are used every place but where they were intended for. Check out these pictures #5 to #12! Run these license plates through the Department of Motor Vehicles and you will find that none of them are owned by the for-profit Laundromat Company where they are used. I doubt that there is any vehicle where it should be in Luverne's companies.

4. Mr. Hoffman has entered the Special Transportation business with M.A. reimbursement. None of the Administrators are allowed to call anyone but "S Specialized Transportation". They even use Rule 53 vans for the additional billed service (Spider, Alexandria and Morris). See enclosed copy of the letter from MNDOT. The Parkview Group Home in Hancock has received an 80% grant from MINDOT for a new van. Watch to see if the FULL price of this vehicle is reported, for 1995, to the M A Program for

reimbursement from the Hoffman Home in Morris! See pages #1 to #3. Additionally, those credits for covering operating costs, I'm sure, will show up some place!

5. Mr. Hoffman brags how he "screwed" the DHS on the Arlington Home. Something about he got them to allow a loan. There is a wire transfer from First Federal Bank in Morris (in the bank's loan files) directly to the owners of the Group Homes in Hancock This is not even close to the Fergus Fall's Arlington Home.

6. The Hoffman Group home in Morris had the Contractor "build-in" an extra $42,000 cost to clear up a judgment in Redwood Falls courts. It's amazing how the judgment between Everstrong Construction and Prairie Community Services was settled when the Morris project was completed! See minutes from the PCS. Trustees' meeting under CEO Report. This is how Mr. Hoffman explains things to his trustees and Boards of Directors with no mention of the lien.

Sincerely,
Patrick M. Hays
10 Pomme de Terre Lane
Morris, MN 56267
(320) 589-4297

cc: Attorney General Humphrey III
Bev Nelson, Analyst/Medicare A
Elaine Dufresne, Department of Human Services

Febuary 23, 1996

Blue Cross Medicare
Bev Nelson
Section W821
Post Office Box 64357
St. Paul, MN 55164

Dear Ms. Nelson,

You are being notified that Medicare/Medicaid Fraud is taking place at St. Francis health Services/Villa of St. Francis (245 262-Medicare) (0026546-Medicade) in Morris,MN. Federal ID Number 23-76-25-632.

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I would strongly suggest that you do a complete audit of the books of St. Francis Health Services, et. al. Please contact me if you have any questions or need any further information or documentation.

Sincerely,

Patrick M. Hayes (former Adm. of VOSF)
10 Pomme de Terre Lane
Morris, MN 56267
cc: Attorney General Hubert H. Humphrey III
102 State Capitol
St. Paul, MN 55155

March 1, 1996

Ms. Elaine DuFresne
Director Long Term Appeals/Audit Division
Department of Human Services
444 Lafayette Road
St. Paul, MN 55155-3836

Dear Ms. DuFresne,

This letter concerns allow and to be allowed employee gifts on Medicaid Cost Reports (Rule 50 & 53).

There is a Chief Executive Officer in Minnesota who dictated that all related/controlled facilities buy boxes of apples from his personal apple orchard. There are well over $20,000 of GIFTS buried in Food Costs and Office Supplies, etc. cacti year. Below is a list of ID numbers. Attached is a copy of employee notes on how well the apples are liked.

RULE 50 PID'S	RULE 53 PID'S	
482343500	082745200	229525300
990343700	382045900	426526200
551218200	632245000	065725500
863278200	582245900	516025100
	692245700	527025100
	653245400	954025300
	773545600	113325000
	763245200	522559100

Thank you for taking care of this matter.

Sincerely,
Patrick M. Hays

March 4, 1996

Ms. Judy Ellison
MN Dept. of Transportation
395 John Ireland Boulevard, MS 430
St. Paul , MN 55155

Re: Public Transportation Grants

Dear Ms. Ellison,

I feel that as a citizen and taxpayers of Minnesota I must disclose the following injustice. Sometime in 1995, the Department of Transportation approved a grant for a Van to transport the aged and handicapped individuals from Hancock, MN to Morris, MN. Prairie Community Wavered Services, Inc. (PCWS) was the grantee. The van arrived in fate 1995 (see picture). Since then, the van has been Located in a Morris Group Home called Hoffman Home and used to transpose residents at a ten bed ICF/MR Rule 53 Group Home owned and operated by Prairie Community Services (PCS).

Additionally, this van is used by St. Francis Health Services of Morris, Inc. (parent company to transport private and Medical Assistance individuals for $ 1.10 (profit). I also believe that somehow the CEO (Luverne Hoffman) plans some way to get reimbursed by Medial Assistance, again, for the same van that was given to PCWS with other intentions for its use. How can something like this continue in our fair State?

A concerned citizen,
Patrick M. Hays
10 Pomme de Terre Lane
Morris, MN 56267

March 12, 1996

Elaine DuFresne
Director of Provider Appeals
444 Lafayette Road
St. Paul, MN 55155-3836

Dear Ms. DuFresne,

I just wanted to inform you of a credit due to the Minnesota Department of Human Resources Medicaid. Sometime between November, 1995 and January, 1996, St. Francis Health Services received a personal check for $413,000 from Kenneth Steiger as some type of refund from the purchase of Leisure Hills Health Center in Hibbing. At the same time, the Financial Director at St. Francis suddenly resigned.

On March 1, I sent you a fetter regarding apple purchases for employee Christmas gifts for December, 1994. Enclosed is more information about these gifts. These, so called, gifts, have increased to approximately $20,000 -$30,000 per year in 1995.

Sincerely,

Patrick M. Hays
10 Pomme de Terre Lane
Morris, MN 56267

cc: Terri Engel
Greg Tabelle

FALSE CLAIMS ACT

HON. HOWARD L. BERMAN

of California
in the house of representatives
Wednesday, July 14, 1999

Mr. BERMAN. Mr. Speaker, I submit the following for the Record:

Hon. Janet Reno,
Attorney General of the United States,
U.S. Department of Justice,
Washington, DC.

Dear Madam Attorney General:

As you know, we are the principal House and Senate sponsors of the 1986 Amendments to the False Claims Act, 31 U.S.C. Sec. 3729, et seq. ("the Amendments"). We have watched with pride the remarkable success of the amendments in bringing to the attention of the federal government hundreds of cases of fraud. We are particularly pleased with the qui tam provisions of the Amendments, which have resulted in cases that have returned $2.3 billion to the federal Treasury.

With dismay, however, we have watched the federal courts interpret several sections of the Amendments in ways that directly contravene Congressional intent, and, of even greater significance, discourage and foreclose potential relators from bringing meritorious cases. In particular, we are

extremely concerned with the courts' crabbed interpretations of the public disclosure bar--Sec. 3730(e)(4)(A) and (B). That provision, which was drafted to deter so-called "parasitic" cases, has been converted by several circuit courts into a powerful sword by which defendants are able to defeat worthy relators and their claims. If this trend continues, we fear that the very purpose of the Amendments--- "to encourage more private enforcement suits"--ultimately will be undermined. See S. Rep. No. 99-345, at 23-24 (1986).

Thus, we believe it is imperative that the Department of Justice ("the Department") adopt and adhere publicly to an interpretation of the public disclosure bar that comports with the plain meaning of the statute and the Congress' obvious intent. The Department's role in this regard is critical. First, of course, the Department is often involved as a party in cases where the public disclosure bar is raised, and it is entitled and expected to make its views known. Even in cases where the Department determines not to intervene, Congress intended for the Department to be involved in monitoring cases, in part to address questions significant to the ongoing operation of the statute. See e.g. Sec. 3730(c)(3) and (c)(4). Finally, as the agency charged, in effect, with the administration of the False Claims Act, the courts are likely to accord significant deference to the Department's interpretation of the Act, and we believe the Department has an obligation to the Congress and to the courts to articulate those views.

With this letter, we intend to provide a detailed explanation of our view of the public disclosure bar, focusing in particular on some of the cases where we believe the courts have misinterpreted the law. In order to place that discussion in context, we want first to explain the origin and significance of the public disclosure bar so that the cases can be viewed in light of Congress' intent.

The public disclosure bar is intertwined inextricably with the history of the qui tam provisions of the statute. From its enactment in 1863, the False Claims Act allowed a relator to bring a qui tam action even if the Government already knew of, investigated and even criminally prosecuted the identical fraud. Such parasitic suites, made infamous in the Supreme Court's decision in Marcus v. Hess, 317 U.S. 537 (1943), allowed relators to recover if they "contributed nothing to the discovery of this crime." Id. At 545. To correct that obvious inequity, Congress enacted the government knowledge bar in 1943, which prohibited qui tam suits based an information in the Government's possession. The government knowledge bar, however, was interpreted too broadly by the courts. If information about fraud was in a file somewhere in the vast federal bureaucracy, a qui tam case was barred even if the government was unaware of the information in its files or had done nothing to pursue it. Indeed, one court held that even if it was the relator him or herself who had reported the fraud to the federal government, their case was precluded on the theory that the government had knowledge of the fraud before the relator filed their case. See, e.g. United States ex rel. State of Wisconsin v. Dean, 729 F.2d 1100 (7th Cir. 1984).

The 1986 Amendment sought to restore some balance between these two extreme regimes. Unquestionably, Congress wanted to prohibit qui tam cases that merely copied a federal criminal indictment and to allow those in which the relator simply informed the government of their allegations before filing suit. But there is considerable terrain between these two poles, and it is here that the courts seem to get lost. The key to navigating the public disclosure bar successfully is understanding Congress' purpose in enacting the Amendments.

Three goals inspired the 1986 Amendments. First and foremost, Congress wanted to encourage those with knowledge of fraud to come forward. Second, we wanted a mechanism to force the government to investigate and act on credible allegations of fraud. Third, we wanted relators and their counsel to contribute additional resources to the government's battle against fraud, both in terms of detecting, investigating and reporting fraud and in terms of helping the government prosecute cases. The reward to the relator is for furthering these goals.

In reversing the old government knowledge bar, however, we wanted to continue to preclude qui tam cases that merely repackage allegations the government can be presumed already to know about because they were disclosed publicly either in a federal proceeding or in the news media. The reason is simple: if the relator simply repeats allegations that he or she heard from someone else and about which the government is already aware and taking action, the relator contributes nothing to the government's efforts to combat fraud. Accordingly, in the 1986 Amendments, we provided that a qui tam case is barred if the relator has based his or her filing upon publicly disclosed allegations unless the relator already has provided information concerning the allegations to the government before filing suit.

Certain courts have exploded this limited bar in ways that mock the very purpose and intent of the 1986 Amendments. A recent case is illustrative. In United States ex rel. Jones v, Horizon Healthcare Corp., No. 97-1635, the Sixth Circuit Court of Appeals held that Ms. Jones' qui tam action was barred because, before she filed her case, she had filed an application for unemployment insurance with the Michigan Employment Security Commission. Her application stated that she had been fired after reporting to her supervisor at

Horizon HealthCare that she believed several claims prepared for submission to Medicare were false. The Court held that Ms. Jones' unemployment application was a public disclosure within the federal government prior to filing her action, her suit was barred.

In both its reasoning and its outcome, Jones strays far from the policies that underlie the public disclosure bar. First, as you know, 3730(e)(4)(A) specifically limits a public disclosure to "allegations or transactions" disclosed in a 'criminal, civil, or administrative hearing, in a Congressional, administrative, or Government Accounting Office report, hearing, audit or investigation, or from the news media." That list is exclusive, as many of the courts to have considered the question agree. See U.S. ex rel. Dunleavy v. County of Delaware, 123 F.3d 734, 744 (3rd. Cir. 1997) (recognizing the.' prevailing view is that this list constitutes an exhaustive rendition of possible sources.") Only an absurdly broad definition of an "administrative hearing" would put an application for unemployment insurance on that list. And Congress did not intend to enact absurdities.

We did intend, and any fair reading of the statute will confirm, that the disclosure must be in a federal criminal, civil or administrative hearing. Disclosure in a state proceeding of any kind should not be a bar to a subsequent qui tam suit: The reason is grounded in the history of the FCA and the policies underlying the 1986 Amendments that we just reviewed. One thing is common to the law throughout its history. It was the Federal Government's knowledge of fraud that triggered the government knowledge bar; it was the federal government's indictment in Marcus v. Hess that formed the basis of the parasitic suit. Thus, when it enacted the public disclosure bar in 1986, Congress was concerned about what the federal government knew about fraud, that is, whether the federal

government had in its possession sufficient information to investigate and pursue allegations of fraud, and whether that information was sufficiently publicized so that the federal government would be forced to act or explain why it chose not to act. As was noted in the Senate 'Report on the Amendments: "Unlike most other types of crimes or abuses, fraud against the Federal Government can be policed by only one body--the Federal Government." S; Rep. 99-345 at 7. To suggest that Congress was concerned with disclosure to anyone other than the federal government when it enacted the public disclosure bar is to ignore history. And to suggest, as the Sixth Circuit held in Jones, that disclosure of fraud to a state agency on an application for unemployment is likely to alert the federal government to fraud is to ignore common sense.[1]

Unfortunately, Jones is by no means an isolated example. U.S. ex ref. Fine v. Advanced Sciences, Inc., 99 F. 3d 1000

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[1] The same is true for civil complaints filed in state court or discovery obtained as a result of state court proceedings, which several Circuits have held constitute public disclosures within the meaning of Sec. 3720(3)(4)(A). See e.g. U.S. ex rel. Kreindler & Kreindler v. United Technologies Corp., 985 F.2d 1148, 1158 (2d Cir.), curt. denied, 113 S.Ct. 2962 (1993) (holding that discovery materials contained in unsealed court records was "publicly disclosed"); U.S. ex rel. Stinson, Lyons, Gerlin & Bustamante v. Prudential Ins. Co., 944 F2d 1149, 1155-56 (3d Cir. 1991) (holding that the disclosure of discovery material--even if not filed in court--constitutes a public disclosure). We believe those cases are wrongly decided. Disclosure of fraud to a state court proceeding, even a state criminal proceeding, is unlikely to get to the attention of the federal government, unless it is publicized in the news media, a contingency the public disclosure bar addresses.

(10th Cir. 1996) is an equally egregious example of judicial overreaching. In Advance Sciences, the Tenth Circuit held, first, that the listed sources in Sec. 3730(3)(4)(A) were not the exclusive means of public disclosure--a holding which, as we have noted already, is simply wrong. The Court went on, however, to hold that a public disclosure occurs whenever the allegations or transactions are provided to any member of the public who is a "stranger to the fraud." In Mr. Fine's case, the stranger was a representative of the American Association of Retired Persons counseling Mr. Fine with respect to a potential age discrimination claim. By public disclosure, we meant disclosure to the public at large, not just one member of the public and certainly not to a confidential counselor. U.S. ex rel. John Doe v. John Doe Corp., 960 F.2d 318 (2nd Cir. 1992), reached a similarly untenable result, holding that disclosure of a government investigation of fraud to the employees of the defendant corporation was during their interviews with government investigators a public disclosure within the meaning of the False Claims Act.

Finally, in this regard, we want forcefully to disagree with cases holding that qui tam suits are barred if the relator obtains some, or even all, of the information necessary to prove fraud from publicly available documents, such as those obtained through a Freedom of Information Act (FOIA) request. See ex rel. Schumer v. Hughes Aircraft Co., 63 F.3d 1512, 1520 (9th Cir. 1995), (finding that a public disclosure would occur only if the relator makes a FOIA request and receives the information requested). We believe that a relator who uses their education, training, experience, or talent to uncover a fraudulent scheme from publicly available documents, should be allowed to file a qui tam action. Cases such as U.S. ex rel. Stinson, Lyons, Gerlin & Bustamante, P.A. v. Prudential Ins. Co., 944 F. 2d 1149, 1150 (3rd Cir. 1991), which held that a " relator must possess substantive

information about the particular fraud, rather than merely background information which enables a putative relator to understand the significance of a publicly disclosed transaction or allegation [.]" undermine Congress' explicit goals. If, absent the relator's ability to understand a fraudulent scheme, the fraud would go undetected, then we should reward relators who with their talent and energy come forward with allegations and file a qui tam suit.[2] This is especially true where a relator must piece together facts exposing a fraud from separate documents.

The consequences of these decisions are alarming. Fraud may well go unpunished and, as a practical matter, undetected. Relators, like Ms. Jones, who are fired from their jobs because they blew the whistle on fraud and then take the not unreasonable step of applying for unemployment insurance will be told by their lawyers that their qui tam case is barred. Congress never intended to force relators to choose between filing a qui tam case and providing for themselves and their families.

The Jones case highlights one aspect of the public disclosure bar that has been widely. misinterpreted by the courts--the question of what constitutes public disclosure. Unfortunately, other issues involving the public disclosure bar also need to be addressed. A second issue concerns how much information needs to be disclosed in order to constitute a disclosure of "allegations or transactions." On this question,

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[2] Some courts do get it right. In U.S. ex rel. Fallon v. Accudyne Corp., 921 F.Supp. 611 (W.D. Wisc. 1995), the court held that an audit report produced by a state agency did not constitute a public disclosure. "Under these circumstances there is no reason to believe that the United States would become aware of such information." Id., at 625.

some, but by no means all, of the courts have held appropriately that in order to trigger the bar, the disclosure must include all of the essential elements of the fraud against a specifically identified defendant. As the Eleventh Circuit observed in U.S. ex rel. Cooper v. Blue Cross and Blue Shield, 19 F. 3d 562, 566 (11th Cir. 1994): "Requiring that allegations specific to .a particular defendant be publicly disclosed before finding the action potentially barred encourages private citizen involvement and increases the changes that every instance of specific fraud will be revealed. To hold otherwise would preclude any qui tam suit once widespread--but not universal--fraud in an industry was revealed." See also U.S. ex rel. Lidenthan v. General Dynamics Corp., 61 F. 3d 1402 (9th Cir. 1995) cert. dented 517 U.S. 1104 (1996) (disclosures that make no mention of specific defendant insufficient to invoke bar).[3]

Not only must the particular defendant be identified, so too must all of the elements necessary to bring a fraud action. As the D.C. Circuit explained in U.S. ex rel Springfield Terminal Ry Co. V. Quinn, 14F.3d 645 (D.C. Cir. 1994), Congress sought to prohibit qui tam actions only when either the allegation of fraud or the critical elements of the fraudulent transaction themselves were in the public domain.." Bits and pieces of information about a defendant and some of its actions--even when publicly disclosed--rarely

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[3] Senator Grassley made a similar comment during the debate on the 1986 Amendments: "The publication of general, non-specific information does not necessarily lead to the discovery of specific, individual fraud which is the target of the qui tam action." False Claims Act Implementation: Hearing Before the Subcomm. On Admin. Law and Gov. Relations of the House Comm. On the Judiciary, 101st cong. 6 (1990) Statement of Senator Grassley.

add up to an allegation of fraud. There must be 'enough information in the public domain to expose the fraudulent transaction." U.S. ex rel. Rabushka v. Crane Co., 40 F.3d 1509, 1513-14 (8th Cir. 1994) quoting Springfield, 14 F.3d at 65. To hold otherwise, as some courts have, would undermine the stated purposes of the False Claims Act.

"Embracing too broad a definition of 'transaction' threatens to choke off the efforts of qui tam relators in their capacity as 'private attorneys general.' By allowing [qui tam] complaint[s] to proceed beyond the jurisdictional inquiry, we help ensure that private actions designed to protect the public fist can proceed in the absence of governmental notice or potential fraud. This is not the type of case that Congress sought to bar, precisely because the publicly disclosed transactions involved do not raise such an inference of fraud."--Id., at 1514.

The last issue we want to raise with respect to public disclosure concern the "original source" exception to the bar. The public disclosure bar applies "unless the action is brought by the Attorney General or the person bringing the action is an original source of the information" 31 U.S.C. Sec. 3730(e)(4)(A). Section 3730(e)(4)(B) defines "original source" as a relator with "direct and independent knowledge of the information on which the allegations are based who has voluntarily provided the information to the Government before filing an action under this section which is based on the information." This provision, too, is a source of considerable confusion and controversy in the courts. Again, however, what Congress intended when it drafted the original source exception is easy to discern both from the statute itself and from its legislative history.

First, the language of the statute makes plain that by

original source," Congress meant an original source of information provided to the government and did not, as some courts have held, add an additional requirement that the relator also be the original source of the public disclosure that triggers the bar. See, e.g. U.S. ex rel. Dick v. Long Island Lighting Co., 912 F.Zd 13 (2d Cir. 1990); U.S. ex rel. Wang v. FMC Corp., 975 F.Zd 1412, 1418 (9th Cir. 1992). There is no statutory nor logical linguistic connection between an original source and the public disclosure that triggers the bar. Of course, a relator could be an original source of the information publicly disclosed, if the relator first provided the information to the Government.

Nor is there any policy rationale that would justify such an interpretation of the original source provision. When Congress enacted the original source provision, we had in mind a scenario where an individual reports fraud to the government and then there is a subsequent public disclosure of the allegations or transactions before that person has filed a qui tam complaint. The disclosure could be, for example, a criminal indictment brought by the Government as a result of the relator's information. It could also be a press story, based on a leak from a Government investigation or an enterprising reporter's investigative skills. Under these circumstances, the relator would not be barred from bringing a qui tam case. To the contrary, he or she should be rewarded for bringing to the Government information about the fraud.

Defendants have also sought the dismissal of relators by urging that "direct and independent knowledge" somehow requires the relator to be an eyewitness to the fraudulent conduct as it occurs. To the contrary, as the Eleventh Circuit concluded to Cooper v. Blue Shield of Florida, Inc., 19 F. 3d 562 (1994) a relator's knowledge of the fraud is "direct and independent" if it results from his or her own efforts. For

example, a relator who learns of false claims by gathering and comparing data could have direct and independent knowledge of the fraud, regardless of his or her status as a precipitant witness.

In light of these policies, it should not be surprising that we support emphatically the courts that have held that Sec. 3730(e)(4)(B) does not require that the qui tam relator possess direct and independent knowledge of "all of the vital ingredients to a fraudulent transaction." Springfield, 14 F.3d at 656-57. As Representative Berman explained, " A person is an original source if he had some of the information related to the claim which he made available to the government . . . in advance of the false claims being publicly disclosed." 132 Cong. Rec. 293Z2 (Oct. 7, 1986).

In closing, we want to urge you to consider seriously the Department's obligation to shape the courts' interpretation of the False Claims Act. We are frankly troubled by the fact that the majority of cases confronting the public disclosure bar are cases in which the Department has not intervened and in which there is no reference at all to the Department's views. To us, it appears that the courts take the Department's decision not to intervene I n a case as a verdict on the merits of the relator's claims and are using the public disclosure bar in order to dismiss the case quickly. Even if some of those cases should be dismissed on the merits, we -cannot countenance a tortured interpretation of the public disclosure bar to reach a desired result.

Moreover, if the public disclosure provisions continue to be misinterpreted, relators and their counsel will be deterred from filing truly meritorious claims.

Further, not all of the cases in which the public disclosure

bar is raised are those in which the government has declined to intervene. Defendants make public disclosure motions after the government has joined a case, and they do so for only one reason: to deprive the government of the resources that relators and their counsel bring to the case. Yet in those cases, too, the Department is typically silent, refusing to take a position on the public disclosure issue. That stance, too, may well undermine Congress' expressed intent.

One of the principal goals of the 1986 Amendments was to ameliorate the "lack of resources on the part of Federal enforcement agencies." S. Rep. 99-345 at 7. That was one of the reasons we strengthened the qui tam provisions of the law. Thus, we expected some meritorious cases to proceed without the Government's intervention, and we fully expected that the Government and relators would work together in many cases to achieve a just result. By dismissing relators based on spurious interpretations of the public disclosure bar, the courts are depriving the government of these additional resources. And those resources have been considerable. In numerous cases, relators and their counsel have contributed thousands of hours of their time and talent and spend hundreds of thousands of their own dollars investigating and pursuing their allegations. The Department must act to protect those resources, even to cases where it has not `intervened. When a question of statutory interpretation arises, particularly with respect to the public disclosure bar, the Department must make its views known to the court.. As we stated emphatically at the time the Amendments were adopted, Congress enacted the Amendments based on the belief that "only a coordinated effort of both the Government and the citizenry will decrease this wave of defrauding public funds." We continue to hold that view.

Sincerely,

Howard L. Berman,
Member of Congress Charles E. Grassley,
U.S. Senator.

Supreme Court, U.S.
FILED

(2)

03 - 92 JUL 7 - 2003

No. _____

In the Supreme Court of the United States

Patrick M. Hays,

Petitioner,

vs.

Luverne Hoffman, et al.,

Respondents,

and

United States of America,

Intervenor.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

SUPPLEMENTAL APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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APPENDIX J: Report and Recommendation of Chief Magistrate Judge, dated April 26, 2001 ..... J-1

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Patrick M. Hays, et al.,

Plaintiffs,

v.

Luverne Hoffman, et al.,

Defendants.

Civil. 97-1656 JMR/FLN

REPORT AND RECOMMENDATION

Brian E. Wojtalewicz, Esq., for Plaintiffs.
Joan Humes, Assistant United States Attorney, for the Government. Janet Newberg, Esq., for Defendants.

THIS MATTER came for a hearing before the undersigned United States Magistrate Judge on March 9, 2001, for resolution of a post-trial issue concerning the number of false claims submitted by Defendants to the Government.

I. BACKGROUND

The Jury returned a verdict finding Defendants liable for violations of the False Claims Act, 31 U.S.C. §§ 3729-3733, as to 11 of the 12 different false claim schemes on the verdict form. (See Defendants' Mem. Concerning False Claims at 1("Defs.' Mem.")). However, the Jury also found that the Government suffered no actual loss. (Id.). The task

before this Court is to determine the exact number of false claims submitted by Defendants to the Government.

II. CONCLUSIONS OF LAW

A. Standard of Review

Congress passed the False Claims Act ("FCA"), 31 U.S.C. §§ 3729-3733, and its *qui tam* action to prevent and prosecute massive frauds perpetrated by large defense contractors during the Civil war, See United States v. Bornstein, et al., 423 U.S. 303, 308 (1976). The FCA allows private litigants to bring actions on behalf of the Government against anyone who:

> (1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval; [or]
>
> (2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government[.]

31 U.S.C. § 3729(a); see also Harrison v. Westinghouse Savannah River Co., 176 F.3d 776, 784 (1999). For purposes of this section, "knowingly" is defined such that "no proof of specific intent to defraud is required," and means that the Defendant: "(1) has actual knowledge of the information; (2) acts in deliberate ignorance of the truth or falsity of the information; or (3) acts in reckless disregard of the truth or falsity of the information." 31 U.S.C. § 3729(b),

Damages under the FCA are two-fold, a civil penalty between $5,000 and $10,000, together with treble actual damages. See 31 U.S.C. § 3729(a)(7). Accordingly, to recover under the FCA, Plaintiffs must prove by a preponderance of the evidence that; (1) Defendants presented false claims for payment to the Government; and (2) Defendants, at the time the claims were submitted, knew that the information submitted in the claims was false, or acted in deliberate ignorance of the truth or falsity of the information submitted in the claims. See 31 U.S.C. § 3729(a) and (b).

B. Legal Analysis

In the instant case, the Jury found that Defendants violated the FCA by committing 11 different false claim schemes. Upon determining that Defendants violated the FCA, the Court had to determine the extent of their monetary liability. As noted above, the FCA provides for treble actual damages. Since the Jury found that the Government sustained no measurable damages, the Court was unable to award actual damages.

The second remedy available to the Government under the FCA is the $5,000.00 to $10,000.00 civil penalty per false claim. As a preliminary matter, it is important to note that this Court lacks the discretion or inherent power to impose penalties below the range set forth in the FCA. See U.S. v. Killough, 848 F.2d 1523 (11th Cir. 1988). Furthermore, civil penalties are recoverable under the FCA even in situations such as the one at bar where Plaintiffs have failed to show actual damages. See U.S. ex rel. Hagood v. Sonoma County Water Agency, 929 F.2d 1416, 1421 (9th Cir. 1991) (citing Rex Trailer Co. v. U.S., 350 U.S. 148, 153 n. 5, (1956)).

As noted earlier, this Court mast determine the exact number of false claims submitted by Defendants for payment

by the Government. Plaintiffs contend that the 11 false claim schemes produced false claim reports that appeared on 28 cost reports, and subsequently led to 336 monthly payment requests or claims (28 annual cost reports multiplied by 12 monthly payment requests). At the other extreme, Defendants argue that at most, 50 false claims are represented by the Jury's verdict. Specifically, Defendants believe that the claims, for the purpose of measuring penalties, are either the central office allocations (for those expenses allocated through the central office) or the cost reports (for those expenses directly identified to a specific facility). Defendants also contend that the imposition of civil penalties in this case would violate the Excessive Fines Clause of the Eighth Amendment to the United States Constitution.[1]

The FCA states that a claim includes any "request or demand...for money or property" where the Government provides any portion of the money or property requested. See 31 U.S.C. § 3729(c); see also Westinghouse Savannah River Co., 176 F.3d at 785. In other words, there must be a call upon the Government fisc and the Court's focus must be upon the specific conduct of the person from whom the Government seeks to collect the penalty. See Bornstein et al., 423 U.S. at 309-10. Under the FCA, each knowingly false "claim for payment" constitutes a separate violation. See 31 U.S.C. § 3729(c).

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[1] As the order referring this issue to the Magistrate Judge says only that the matter is referred for Report and Recommend "on the number of false claims submitted by defendants to the government," this Court offers no opinion as to whether the civil penalties at issue would violate the Excessive Fines Clause of the Eighth Amendment to the United States Constitution.

In the present case, plaintiffs expert witness, Robert Rau, provided uncontroverted testimony at trial concerning the number of monthly payment requests or claims submitted by Defendants. Specifically, Mr. Rau testified that the falsely claimed expenses of the 12 different schemes were each within a certain number of the 29 cost reports filed for each of Defendants' group homes and subsequently, within a certain number of the monthly payment requests for Medicaid submitted by Defendants between 1994 and 1995. Additionally, both parties' arguments at the March 9, 2001, hearing revealed that the monthly payment requests triggered payment by the Government.[2]

Consequently, this Court concludes that the submission of a payment request was the act which caused the false claims relating to these schemes to be presented to and paid by the Government. These payment requests were in fact the "request or demand" on the Government fist. Accordingly, because the payment requests were made each month between 1994 and 1995 for each of the 28 cost reports and each false claim for payment constitutes a separate FCA violation, the request or demand for payment on the false expense claims was made to the Government 336 times (28 annual cost reports multiplied by 12 monthly payment requests).

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[2] The manner in which nursing homes are reimbursed by the Medicaid system begins with the submission of an annual cost report to the Minnesota Department of Human Services ("DHS"). The DHS then takes the information in that cost report and sets a rate, per patient, per month, that it will pay the facilities. Once the facilities are notified of the new rate, they submit a payment request on a monthly basis.

III. RECOMMENDATION

Based upon all the files, records and proceedings herein, **IT IS HEREBY RECOMMENDED** that Defendants be held liable for knowingly presenting 336 false claims for payment or approval to the Government in violation of the False Claims Act.

Dated: April 26, 2001

s/FRANKLIN L. NOEL
Chief Magistrate Judge

Pursuant to Local Rule 72.1(c)(2), any party may object to this Report and Recommendation by filing with the Clerk of Court and serving on all parties, within ten days of service of this Report and Recommendation, written objections which specifically identify the portions of the proposed findings, recommendations or report to which objection is being made, and a brief in support thereof. A party may respond to the objecting party's brief within ten days after service of the objections. All briefs filed under this rule shall be limited to ten pages. A judge shall make a de novo determination of those portions to which objection is made.

This Report and Recommendation does not constitute an order or judgment of the District Court, and it is therefore not appealable to the Circuit Court of Appeals.

(3)

No. 03-92

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In The
Supreme Court of the United States

PATRICK M. HAYS,

Petitioner,

vs.

LUVERNE HOFFMAN, et al.,

Respondents,

and

UNITED STATES OF AMERICA,

Intervenor.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED FOR REVIEW

Does a qui tam relator's knowledge of (a) allegations he obtained secondhand from a coworker and (b) allegations he obtained from a Medicaid audit he triggered qualify as "direct and independent knowledge" sufficient to survive the jurisdictional bar of 31 U.S.C. §3730(e)(4)?

Is the Eighth Circuit's decision imposing civil penalties in the amount of $80,000 consistent with this Court's decision in *United States v. Bornstein*?

Does the public disclosure of a state Medicaid agency's compliance audit report invoke the jurisdictional bar of 31 U.S.C. §3730(e)(4)(A)?

Should this Court grant certiorari to resolve a conflict among the circuits where the conflict did not affect the Eighth Circuit's decision?

STATEMENT PURSUANT TO RULE 29.6

St. Francis Health Services of Morris Inc. is a privately held corporation exempt from taxation due to its affiliation with the Catholic Diocese of St. Cloud, Minnesota. It is the parent corporation of Villa of St. Francis Nursing Home Inc., Browns Valley Health Center Inc., Franciscan Health Center Inc., Leisure Hills Health Center, Inc., Prairie Community Services Inc., Prairie Community Waivered Services Inc., and Prairie Land Management Services Inc.

St. Louis Riverview Homes Inc. is privately held and does not have a parent corporation.

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STATEMENT OF THE CASE

St. Francis Health Services ("SFHS") is a non-profit organization that provides health care services to the elderly and disabled in central and western Minnesota.

Patrick Hays was employed by SFHS as a nursing home administrator from 1992 until 1996. He was terminated for incompetence in February of 1996 and offered a lateral position in another part of the company. He began work in the new lateral position on February 26, 1996.

During his employment as a nursing home administrator, Hays learned that SFHS purchased $6,000 worth of apples as holiday gifts for employees but recorded the cost on company books as "resident food". Hays believed that SFHS did this to obtain Medicaid reimbursement for an otherwise unallowable expense. Late in Hays' employment, SFHS Director of Finance Tom Conner told Hays of suspicions Conner had that SFHS engaged in other financial wrongdoing.

Hays drafted "whistleblower" letters and mailed them to the state Medicaid agency (the "DHS") on Friday, February 23, 1996. Hays made allegations of Medicaid fraud concerning the apples in these letters. Additionally, Hays related what Conner told him about Conner's suspicions. Hays brought copies of the letters with him when he started work in the new lateral position on February 26, 1996. Hays showed these letters to SFHS' CEO, and the CEO fired Hays.

The DHS began a field audit of SFHS following receipt of Hays' letters. The DHS issued its audit reports in January of 1997 and made several downward adjustments to SFHS' rates. Nearly all of the audit adjustments were unrelated to the specific allegations contained in Hays'

whistleblower letters. A Medicaid auditor testified at trial that the majority of the allegations in Hays' whistleblower letters were false, erroneous, or resulted in no audit adjustments by the DHS. The DHS did disallow expense related to the purchases of apples and made corresponding adjustments to SFHS' rates.

After the DHS released its audit reports, Hays called the DHS and obtained copies of the reports. The Morris, Minnesota Tribune also obtained copies of the audit reports and published an article about the audit findings. Several months later, Hays' filed his Complaint in this matter alleging that SFHS, its subsidiaries and its upper management violated the False Claims Act by submitting false claims for reimbursement to the Medicaid program. Hays also alleged that he was wrongfully terminated in violation of both federal and state law.

Hays' *qui tam* allegations consisted of the DHS audit findings. Hays attached copies of the audit reports to his Complaint and incorporated all of the audit findings into the counts of his Complaint.

At trial, Hays claimed the defendants violated the False Claims Act in twelve different ways, causing a total loss to the U.S. government of $27,459.00. These twelve items were included in the DHS audit reports, but, other than allegations concerning the apples, were not otherwise specifically alleged in Hays' Complaint.

After trial, the jury found that defendants had submitted false claims regarding eleven different items, but the false claims caused no measurable damages to the United States. The district court then determined that defendants submitted a total of 336 false claims and

imposed the statutory minimum $5,000 fine for each false claim resulting in a total penalty of $1,680,000.

Of the 11 types of false claims represented by the jury verdict, the Eighth Circuit determined that *only* the allegations concerning apples originated with Hays. The Eighth Circuit also found most of the other allegations were not volunteered by Hays in his whistleblower letters to DHS, and Hays obtained information concerning the remaining allegations from Tom Conner. *Hays v. Hoffman*, 325 F.3d 982, 990 (8th Cir. 2003).[1]

Defendants appealed the *qui tam* portion of the judgment. The Eighth Circuit determined that Hays was the original source only of the allegations concerning the apples, and the district court lacked subject matter jurisdiction over the remaining allegations. The Eighth Circuit also found that Hays presented no credible evidence concerning the identity and number of claims presented by defendants. The Eighth Circuit conducted its own review of the trial record, determined that there were only 8 false claims concerning the apples, and imposed a $10,000 penalty for each of these claims.

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[1] Hays claims in his Petition that he made allegations in his whistleblower letters concerning 10 of the 11 false claims found by the jury. Petition at 3. Hays is mistaken. Defendants provided the Eighth Circuit with a table identifying each of the 11 false claims items and the source of allegations concerning those items to demonstrate that Hays did not address most of these 11 items in his whistleblower letters. Appellants' Reply Brief, pps. 13-16. The Eighth Circuit agreed with defendants' factual analysis.

ARGUMENT

I. A QUI TAM RELATOR DOES NOT HAVE "DIRECT AND INDEPENDENT KNOWLEDGE" OF ALLEGATIONS HE OBTAINS SECOND HAND AND ALLEGATIONS HE LEARNS FROM AN AUDIT HE TRIGGERS

The False Claims Act allows a private individual to bring a civil action under the qui tam provisions of the Act. Congress established a jurisdictional bar to prevent various types of parasitic actions:

> No court shall have jurisdiction over an action . . . based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.

31 U.S.C. §3730(e)(4)(A). The allegations were publicly disclosed in the state Medicaid agency audit reports as discussed in Argument III and in the Morris Tribune newspaper article. Therefore the question arises whether Hays was an "original source" of the information.

A relator is not an "original source" of publicly disclosed information unless that relator had direct and independent knowledge of the information upon which the allegations are based and that information was voluntarily brought forward to the government prior to filing the suit. 31 U.S.C. §3730(e)(4)(B).

Hays argues he is an original source and meets the "direct and independent knowledge" requirement because

he obtained information from Conner and passed it on to the DHS. Additionally, Hays argues that all employees who serve as whistleblowers against their employers should be deemed to meet the "direct and independent knowledge" requirement regardless of where the employees obtained the information supporting their allegations. Hays Petition, p. 11.

In his Petition, Hays did not address the Eighth Circuit's factual finding that Hays obtained most of his allegations from the DHS audit reports and not from Conner. Hays does not qualify as an "original source" of information he obtained from the DHS audit reports merely because he triggered the Medicaid audits. To hold otherwise would render meaningless the "direct and independent knowledge" requirement set forth in 31 U.S.C. §3730(a)(4)(B). Additionally, permitting *qui tam* suits by individuals who do no more than trigger a federal or state investigation "would undermine the balance intended by Congress in section 3730(e)(4) between encouraging private citizens to expose fraud unknown to the federal government and preventing parasitic suits by would-be relators who disclose no new information". Brief of Intervenor United States, pps. 35-36. Individuals who simply trigger audits cannot be said to have "direct and independent knowledge" of the audit results. *See United States, Plaintiff, Surender Dhawan & Dennis Gowie, appearing Qui Tam on behalf of the United States of America v. New York Medical College*, 252 F.3d 118, 121 (2nd Cir. 2001). The Eighth Circuit correctly found that Hays did not have "direct and independent knowledge" of allegations he learned from the DHS audit reports.

The Eighth Circuit also correctly determined that Hays did not have direct and independent knowledge of

allegations he learned from Conner and passed on to the state Medicaid agency in his whistleblower letters. "Direct and independent knowledge" is "knowledge that is marked by absence of an intervening agency" or "unmediated by anything but [the relator's] own labor." *Minnesota Association of Nurse Anesthetists, United States ex rel v. Allina Health System*, 276 F.3d 1032, 1048-1049 (8th Cir. 2002), citing *United States ex rel Barth v. Ridgedale Elec. Inc.*, 44 F.3d 699, 703 (8th Cir. 1995). A person who obtains secondhand information from another does not possess direct knowledge and therefore is not an original source. *Barth* at 703; *United States ex rel Laird v. Lockheed Martin*, 2003 WL 21452609 pps. 7-8 (5th Cir. (Tex.)).

Accordingly, Hays was the "original source" only of allegations concerning apples. The Eighth Circuit properly determined the district court lacked jurisdiction over the remaining allegations.

II. THE EIGHTH CIRCUIT CORRECTLY APPLIED *UNITED STATES V. BORNSTEIN* WHEN IT IDENTIFIED AND COUNTED THE FALSE CLAIMS

Hays argues the Eighth Circuit misconstrued the Court's holding in *United States v. Bornstein*, 423 U.S. 303 (1976) and inappropriately identified and calculated the "claims" submitted to the government. Hays misreads *Bornstein*. The Eighth Circuit faithfully applied *Bornstein* and, with the absence of any credible proof by Hays of the nature and quantity of claims submitted by SFHS, identified and performed its own calculations of the false claims.

Hays argues that "the rule in *Bornstein* [is] that the number of civil penalties imposed should be based upon

the number of claims made". Hays Petition p. 12. *Bornstein* did not so hold. This Court actually held that a correct application of the language of the False Claims Act requires that the focus in each case be upon the specific conduct of the person from whom the Government seeks to collect the statutory forfeitures. *Bornstein* at 529. Accordingly, this Court in *Bornstein did not* impose a civil penalty for each claim submitted by the prime contractor; it imposed a civil penalty for each culpable act of the subcontractor. *Bornstein* at 530.

Here, the Eighth Circuit found that SFHS purchased approximately $6,000 worth of apples, gave them to employees during the holiday season, and falsely claimed Medicaid reimbursement for the expense. The Eighth Circuit noted that due to the Medicaid reimbursement system then in place for certain health care facilities, this expense was reflected in multiple facility cost reports. The DHS used these cost reports to calculate payment rates which applied to all covered services over the following year. Under this system, a one-time expense for a multi-facility provider like SFHS may be reimbursed over hundreds or many thousands of claims for reimbursement of services provided to individual residents.

Hays sought civil penalties based on the number of claims for reimbursement SFHS submitted each month for every resident in its facilities. Hays argued that given this reimbursement methodology he could have asked for penalties based on more than 100,000 claims instead of 336 claims. Given the statutory penalty range of $5,000-$10,000 per claim, this would have resulted in potential penalties of $500,000,000 - $1,000,000,000 – all for conduct the jury determined resulted in no measureable loss to the government.

The Eighth Circuit found that Hays failed to offer any of the false claims into evidence at trial, and failed to explain the manner or frequency in which SFHS facilities submitted payment requests to the DHS. The Eighth Circuit characterized Hays' attempts to identify and quantify the claims in this case as "unsupportable as a matter of law" and as an "unsubstantiated guess". *Hays* at 993.

The Eighth Circuit, following this Court's direction in *Bornstein*, focused on the specific conduct of SFHS leading to the submission of false claims concerning apples. The Court reviewed the record and determined that gift apples were claimed by eight SFHS facilities and subsequently disallowed by the DHS. The Eighth Circuit appropriately determined that SFHS was liable for 8 false claims, and imposed the maximum statutory penalty on each of $10,000.

The Eighth Circuit appropriately applied *Bornstein* to the facts of this case.

III. THE PUBLIC DISCLOSURE OF A STATE MEDICAID AGENCY'S COMPLIANCE AUDIT REPORT INVOKES THE FALSE CLAIMS ACT'S JURISDICTIONAL BAR

The jurisdictional bar in the False Claims Act provides in part that "no court shall have jurisdiction over an action . . . based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative or Government Accounting Office report, hearing, audit, or investigation, or from the news media . . .". 31 U.S.C. §3730(e)(4)(A). The allegations in Hays' complaint were publicly disclosed in

both the DHS audit reports and in the Morris Tribune newspaper article before Hays filed his Complaint[2]. Hays argues that allegations disclosed in the DHS audit reports do not qualify as "public disclosures" because the DHS is a state agency, and the jurisdictional bar only applies to matters disclosed in *federal* reports, hearings, audits or investigations.

The Eighth Circuit noted that Medicaid is a cooperative federal-state program through which the federal government provides financial assistance to assist States in furnishing health care to the poor. Although state agencies administer Medicaid, they do so under detailed federal statutory and regulatory controls. State Medicaid agencies, including the DHS, must audit records that support cost-based payments to vendors. 42 C.F.R. §447.202. These agencies must also adopt Fraud Detection and Investigation Programs, conduct preliminary investigations whenever they receive a complaint of Medicaid fraud or abuse, and must request full investigations by the state's Medicaid Fraud Control Unit if the agency's preliminary investigation gives it reason to believe an incident of fraud or abuse has occurred. The results of these investigations must be reported to the Department of Health and Human Services ("HHS"), 42 C.F.R. §455.15(a) setting the stage for either federal or state criminal or civil enforcement actions. *See* Minn. Rules §9549.0041 subd. 15c. State Medicaid agencies, including the DHS, clearly act as agents for the federal government in its Medicaid fraud and abuse detection efforts.

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[2] The Eighth Circuit did not address defendants' argument that the Morris Tribune article also constituted a public disclosure.

The Eighth Circuit noted that this subpart of §3730(e)(4)(A) has not been rigidly limited to disclosures by federal agencies in other contexts. In *Minnesota Association of Nurse Anesthetists* the Court described an audit performed by an insurer on behalf of HHS as an "administrative audit" that could trigger the jurisdictional bar. Similarly, in *United States ex rel Schwedt v. Planning Research Corp.*, 39 F.Supp. 2d 28, 31-33 (D.D.C. 1999) the court held that public disclosures in an audit report prepared for the federal government by an outside accounting firm satisfied the jurisdictional bar.

Anti-fraud compliance audits conducted by state agencies should qualify as public disclosures if they are prepared by or at the behest of the relevant federal agency, or by or at the behest of a state agency that administers the federal grant program under significant Federal regulation and involvement.

Hays cites *United States ex rel Dunleavy v. County of Delaware*, 123 F.3d 734, 745 (3rd Cir. 1997) in support of his proposition that only disclosures by *federal* agencies implicate the jurisdictional bar, and his argument that what the Eighth Circuit did here creates a conflict between the two circuits. *Dunleavy* is distinguishable on the facts. The alleged disclosure in that case was a county report submitted to the Department of Housing and Urban Development by the unit of local government accused of violating the FCA. The Third Circuit noted "those reports have been compiled and produced by a party whose principal motivation (assuming the truth of the fraud claim) is the elimination of the paper trail of fraud". 123 F.3d at 745. Additionally, under the federal grant program at issue in *Dunleavy*, grantee compliance audits are conducted by

federal agencies, and not state agencies acting as agents for the federal government. The Eighth Circuit concluded that the Third Circuit ruled "more broadly than necessary" in concluding that a state agency disclosure may never be an "administrative . . . report [or] audit" for purposes of §3730(e)(4)(A).

Finally, if the DHS is merely a state agency, then Hays loses his jurisdictional qualification as an "original source" on a separate ground. Title 31 U.S.C. §3730(e)(4)(A) provides in part that an original source is one who has "voluntarily provided the information to the Government before filing an action". The word "Government" refers to the *federal* government. *United States ex rel Jones v. Horizon Healthcare Corp.*, 160 F.3d 326, 334 (6th Cir. 1999). The record is devoid of any evidence that Hays reported his allegations to any government entity other than the DHS before he filed his FCA complaint. If the DHS is not a federal agency for purposes of the public disclosure bar, then it is also not a federal agency for purposes of the voluntary reporting requirement.

IV. THIS COURT SHOULD NOT GRANT CERTIORARI TO RESOLVE A CONFLICT AMONG THE CIRCUITS WHERE NO CONFLICT EXISTS

Hays urges this Court to resolve a conflict among the circuits and find, as only the Fourth Circuit has, that the phrase "based upon" in the FCA jurisdictional clause means "derived from" and not "substantially similar to". The Eighth Circuit and the majority of circuits have interpreted "based upon" to mean "supported by".

While this may present an interesting exercise in statutory interpretation, it is wholly unnecessary here. The Eighth Circuit properly noted that Hays virtually conceded his complaint was "based upon" the public disclosure in the DHS audit reports because he drew the factual allegations in his Complaint directly from the DHS audit reports, and actually attached the audit reports to his Complaint. *Hays* at 987-988. The Eighth Circuit noted that suits are "based upon" public disclosures of allegations if they are "derived from" (the minority view) or "supported by" (the majority view) the disclosures. The Eighth Circuit apparently found that regardless of which definition is used, Hays' allegations *were* "based upon" the DHS audit reports. Hays' Complaint *was* the DHS audit reports with a case caption attached.

CONCLUSION

For the reasons set forth above, Respondents respectfully request that the petition for writ of certiorari be denied.

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Respectfully submitted,

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